Economic Research

MALAYSIAN RATING CORPORATION BERHAD
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#WhatWeThink: Budget 2021

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Hard choices, difficult trade-offs

- Budget 2021 signifies the country's first short-term fiscal priorities during a historical pandemic. It sets the tone for the federal government's budgets in the coming years as we await the unveiling of the 12th Malaysia Plan (12MP) in early 2021.

- The government faces a difficult trade-off in stimulating demand at a time when supply faces intermittent disruptions. There are clear-cut attempts to ensure that fiscal discipline is kept in check, most notably by establishing a separate emergency-themed financial account under the COVID-19 Fund. As a developing economy, in general, we feel that the government could have taken a much bolder step by employing a short-term debt stabilisation policy at this time of crisis.

- Our underlying concern about Budget 2021 is focused on revenue collection rather than expenditure. We applaud the government's move to expand expenditure as widely as it possibly can to reach every segment of the population. However, improving the revenue-to-GDP ratio must be a continuous effort to enable development expenditure (DE) to move in tandem with operating expenditure (OE).

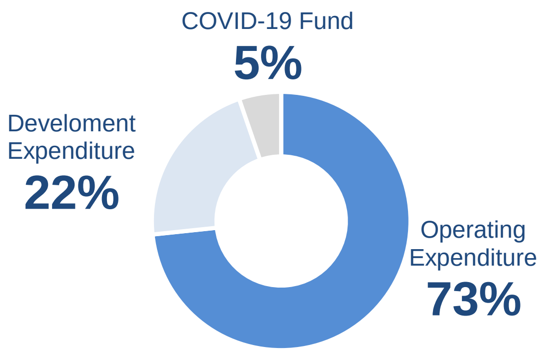
- We do not anticipate a downgrade on the horizon following the unveiling of this Budget. However, the government's middle- to long-term fiscal priorities may need to translate to bold reforms in order to mitigate such a risk.

- All in all, economic recovery is contingent upon how quickly governments can normalise economic activities internally as well as externally post-COVID-19. As one of the world's largest trading nations, the reopening of Malaysia's borders will allow for a speedier trajectory towards full recovery.

BUDGET 2021: SNAPSHOT

THEME: TEGUH KITA, MENANG BERSAMA

ALLOCATION (TOTAL: RM322.5 BILLION):



THREE INTEGRAL GOALS:

RAKYAT'S WELL-BEING

- **Strategy 1:** COVID-19 Pandemic and Public Health
- **Strategy 2:** Safeguarding the Welfare of Vulnerable Groups
- **Strategy 3:** Generating and Retaining Jobs
- **Strategy 4:** Prioritising the Inclusiveness Agenda
- **Strategy 5:** Ensuring the Well-Being of the *Rakyat*

BUSINESS CONTINUITY

- **Strategy 1:** Driving Investments
- **Strategy 2:** Strengthening Key Sectors
- **Strategy 3:** Prioritising Automation and Digitalisation
- **Strategy 4:** Enhancing Access to Financing

ECONOMIC RESILIENCE

- **Strategy 1:** Expansionary Budget
- **Strategy 2:** Development Agenda under the 12th Malaysia Plan
- **Strategy 3**: Enhancing the Role of GLCs and Civil Society
- **Strategy 4:** Ensuring Resource Sustainability
- **Strategy 5:** Civil Service

Testing the limits of fiscal discipline

- Expansionary Budget 2021 is a commendable effort to balance the difficult act of cushioning COVID-19's economic, financial and human impacts on one hand, and setting the stage for recovery on the other hand. The former comes from the angle of improving crisis response and strengthening social safety nets, while the latter from traditional Keynesian pump-priming. To help fund fiscal initiatives to deal with the pandemic, the government has set up the COVID-19 Fund, a new category of allocation.

- We see Budget 2021's total expenditure allocation of RM322.5 billion (2020: RM314.7 billion) – the largest ever recorded – justified to preserve lives and livelihoods. The allocation reflects the government's praiseworthy efforts to accommodate the needs of an economy in distress despite its fiscal limitations. The government proposes to allocate around RM236.5 billion for OE and RM69.0 billion for DE in Budget 2021.

Table 1: Government financial position

	2017		2018		2019		2020E		2021F	
	RM Bil	% GDP	RM bil	% GDP	RM bil	% GDP	RM bil	% GDP	RM bil	% GDP
Total revenue	220.4	16.3	232.9	16.1	264.4	17.5	227.3	15.8	236.9	15.1
Direct tax revenue	116.0	8.6	130.0	9.0	134.7	8.9	115.1	8.0	131.9	8.4
Indirect tax revenue	61.6	4.6	44.0	3.0	45.8	3.0	38.2	2.7	42.5	2.7
Non-tax revenue	42.7	3.2	58.8	4.1	83.8	5.6	74.0	5.1	62.5	4.0
Total expenditure	260.7	19.3	286.3	19.8	315.9	20.9	275.7	19.2	304.7	19.4
OE	217.7	16.1	231.0	16.0	263.3	17.4	226.7	15.8	236.5	15.1
Net DE	43.0	3.2	55.3	3.8	52.6	3.5	49.0	3.4	68.2	4.3
COVID-19 fund*	-	-	-	-	-	-	38.0	2.6	17.0	1.1
Overall balance	-40.3	-3.0	-53.4	-3.7	-51.5	-3.4	-86.5	-6.0	-84.8	-5.4

**A specific trust fund established under Temporary Measures for Government Financing (COVID-19) Act 2020 to finance economic stimulus packages and recovery plan*

Sources: Ministry of Finance (MoF), Bank Negara Malaysia (BNM), CEIC, MARC ERD

- Although Budget 2021 carries much of the aspiration for targeted fiscal redistribution under the Shared Prosperity agenda, it is truly the first of its kind on many fronts. Not only is it the first budget under the 12MP, it is also Perikatan Nasional's maiden financial blueprint. Note, however, that this is the first time a budget has been announced ahead of the five-year development plan, in this case, the 12MP. As such, there is no inkling of how Budget 2021 fits into the 12MP. In any case, Budget 2021 holds the crown as the biggest federal budget in the history of the country. Were it not for COVID-19, and the fact that it was unveiled in the middle of the current election cycle, some would have considered it an "election budget."

- The government's upward revision of its budget deficit target in 2020 to 6.0% of GDP from an initial estimate of 3.2% partly reflects additional fiscal stimulus injections totalling RM55.0 billion. This would mark the highest budget deficit recorded since the 2009 Global Financial Crisis' 6.7%. For 2021, the government expects the fiscal deficit to come in at 5.4%, which is within our forecast range of 5.0% to 5.5%. It expects the budget deficit to moderate to an average of 4.5% over the medium term. There are, however, downside risks to this medium-term projection. Besides the damage already inflicted on the economy, the public health and economic crisis could be prolonged, with obvious implications for revenue and expenditure. The rise in fiscal deficit is justified in any case given the necessity to support businesses and the *rakyat* to mitigate the deleterious impact of the pandemic.

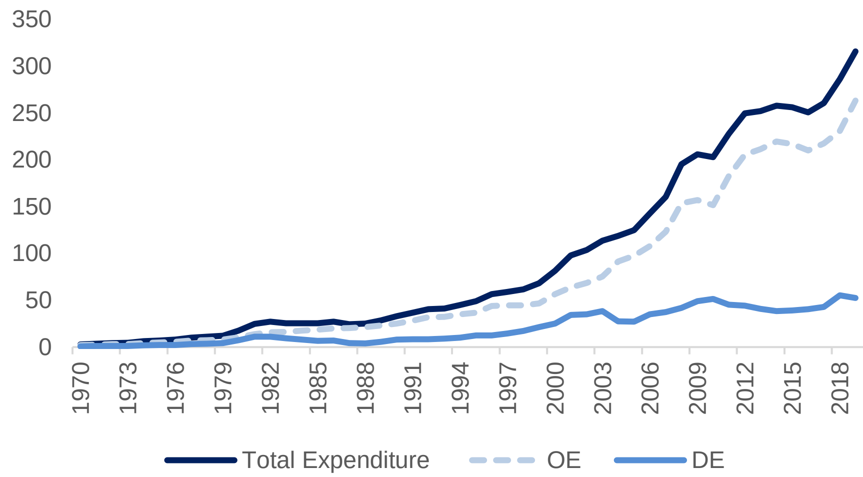
- In Budget 2021, the government has heeded the call to continue its vital assistance programmes for struggling SMEs as well as the people from within the B40 and M40 communities. The government has vowed to extend its wage subsidies, digitalisation grants and social safety net, as well as improve accessibility to financing. Its plan to allocate RM75 billion to encourage a cashless economic culture under the eBelia programme, for example, is a laudable initiative.

- As anticipated, the government will allocate resources to improve human capital through reskilling and upskilling programmes. We applaud the move to galvanise government agencies to pivot Malaysia towards digitalisation and improve the agility of the *rakyat* to move towards more innovative and productive livelihoods going forward. We are concerned, however, that reskilling and upskilling efforts are more often than not aimed at helping those that have fallen out of employment to find new jobs, rather than moving Malaysia up the technology chain. Notwithstanding this, we acknowledge efforts to encourage movement to industries higher up the value chain.

- As far as revenue is concerned, we note the government's optimistic projection that both corporate and personal income tax revenue collections will fully recover to pre-COVID-19 levels. We opine that this is conditional on the absence of a Movement Control Order (MCO) and a complete resumption of economic activities, internally and externally, throughout 2021. Given that there is still no proven effective vaccine for COVID-19, a resurgence of infections could remain the norm; thus, we see downside risks. In other words, there is still the possibility that Malaysia could face a U-shaped recovery rather than a V-shaped recovery in 2021.

- The government recently announced that PETRONAS will provide revenue relief amounting to RM34 billion in 2020. Going forward, we foresee this to continue given the expectation that Malaysia's revenue-to-GDP will continue to moderate over time. Furthermore, OE has been rapidly rising in ringgit terms, a reflection of the growing costs of running the federal government. It does not help that Malaysia has a narrow tax base.

Chart 1: Total expenditure, OE and DE (RM bil)



Sources: MoF, CEIC

- While calls for the government to expand its tax base will continue to grow, major government-linked companies (GLCs) and government-linked investment companies (GLICs) will step in to provide income relief when necessary. Besides this, GLCs have also been tasked with creating jobs under the budget proposal, although there is a lack of clarity on this measure. Concerns on whether such job creation will eventually be absorbed into permanent employment will continue to linger.

- In mitigating the impact of COVID-19, higher deficit spending is warranted not only as a counter-cyclical measure but also to maintain the stability of the healthcare system. It is also important to ensure that efforts to flatten the COVID-19 infection curve do not come at the expense of care for other critical illnesses.

- To support larger deficit spending, the Parliament recently approved a higher statutory debt ceiling by an additional 5 percentage points to 60% of the GDP. It is important to note that this increase is temporary and will remain until end-2022. Given the higher debt-to-GDP, however, debt service continues to rise and is already the second-largest component of OE after emoluments and pensions.

- Meanwhile, the issuance of new debt to finance the COVID-19 Fund could keep debt service further entrenched in its current trend. It is notable that the COVID-19 Fund will be used as part of OE, albeit separated from the main account, which is a concern from the perspective of prudent fiscal management. However, we acknowledge that extraordinary times call for extraordinary measures and we see it justified in this time of crisis.

Table 2: Government debt

	2017		2018		2019		1H2020	
	RM bil	% GDP	RM bil	% GDP	RM bil	% GDP	RM bil	% GDP
Domestic debt	484.1	35.8	562.2	38.9	585.3	38.7	649.2	44.9
MGS	200.2	14.8	234.2	16.2	230.2	15.2	263.7	18.2
GII	249.5	18.4	288.4	19.9	317.7	21.0	331.6	22.9
Treasury bills	1.2	0.1	2.8	0.2	3.0	0.2	20.7	1.4
Other loans	33.2	2.5	36.8	2.5	34.4	2.3	33.2	2.3
External debt	202.8	15.0	178.8	12.4	207.7	13.7	204.8	14.2
Non-resident holdings of RM-denominated debt	186.2	13.8	162.1	11.2	183.7	12.2	179.8	12.4
Offshore borrowing	16.6	1.2	16.7	1.2	24.0	1.6	25.1	1.7
Total government debt	686.8	50.7	741.0	51.2	793.0	52.5	854.1	59.0

Sources: BNM, MARC ERD

- With fiscal policy expected to continue playing the main supporting role in 2021, and assuming that the current recovery momentum continues, we expect the central bank monetary policy to remain accommodative through the end of the year. Against this backdrop, we expect consumer and business confidence to also improve when supply disruptions dissipate in time.

- However, this may not necessarily lead to the desired level of increased spending and investment. Given the pandemic's scarring effects on the economy, we expect a higher propensity to save. In any case, the fact that it remains unclear when the first batch of COVID-19 vaccines will be ready and how much protection they will be able to provide, will continue to weigh on confidence. In this respect, we expect fiscal tensions to remain in the pandemic economy on the back of the government's fiscal limitations.

- The current domestic COVID-19 resurgence shows that the risk of future outbreaks will never go away sans a vaccine. This also implies that international borders could remain mostly closed, a rather dire situation given the role played by Malaysia's services sector, in particular the tourism industry. If further outbreaks in 2021 result in strict MCOs nationwide, or even in major growth areas, this will dampen economic recovery and necessitate further stimulus packages, as well as possibly a monetary policy response. In other words, a full recovery could prove unlikely.

- Without a doubt, we see this as a test of fiscal discipline at a whole new level because the question of when and how we recover from this crisis is highly debatable. Given the present political landscape, it is understandable that the government is exercising great self-restraint when approaching the issue of debt, despite the unprecedented crisis. In any case, the propensity of the government to be overly optimistic about economic recovery while underestimating the impact of rising debt is within our expectations.

- It is important to point out that many countries face the same prospect of credit downgrades due to this intertwined health and economic crisis; this, however, is no excuse to not complement the government's extraordinary fiscal response with deep middle- to long-term reforms.

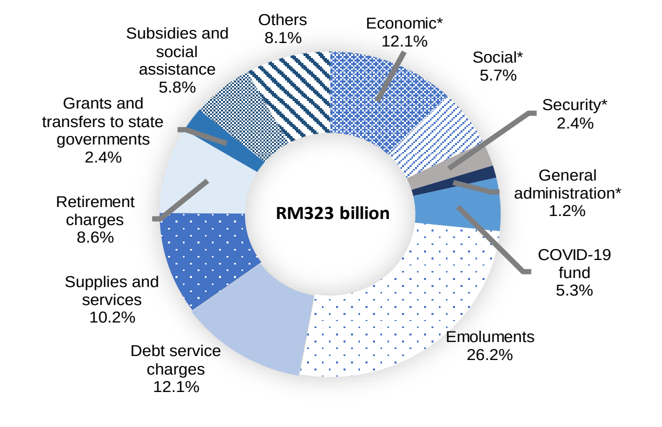
Table 3: GDP growth on the demand side

Growth (% y-o-y)	2016	2017	2018	2019	*MARC*		*MoF*	
					2020F	*2021F*	*2020F*	*2021F*
GDP	4.4	5.8	4.8	4.3	-6.3	6.2 - 6.7	-4.5	6.5 - 7.5
Domestic demand	4.3	6.5	5.5	4.3	-4.3	5.4	-3.0	6.9
Private consumption	5.9	6.9	8.0	7.6	-2.0	5.5	-0.7	7.1
Public consumption	1.1	5.7	3.2	2.0	4.7	3.8	1.6	2.0
Private investment	4.5	9.0	4.3	1.6	-13.4	6.3	-11.7	6.7
Public investment	-1.0	0.3	-5.0	-10.8	-19.5	5.7	-9.3	16.9
Real exports	1.3	8.7	1.9	-1.3	-5.8	4.3	-13.4	8.7
Real imports	1.4	10.2	1.5	-2.5	-8.0	5.9	-11.9	9.2

Sources: MoF, CEIC, MARC ERD

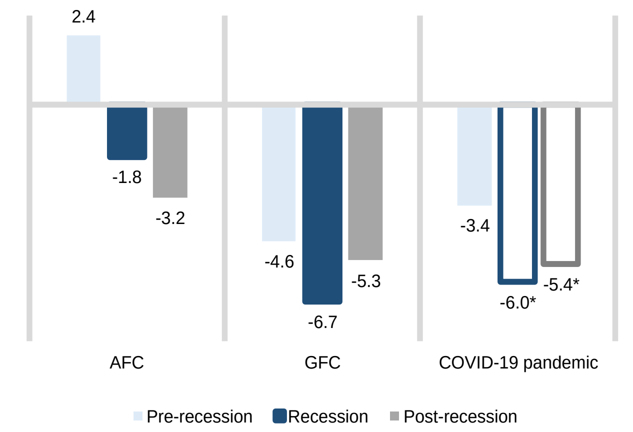
Appendix

Chart 2: Budget 2021 – Spending allocation



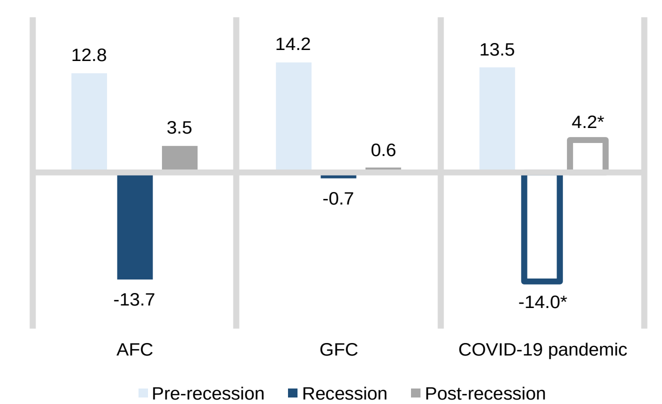
*Items with * = DE; items without * = OE*
Source: MoF

Chart 3: Fiscal balances during past crises (annual, % of GDP)



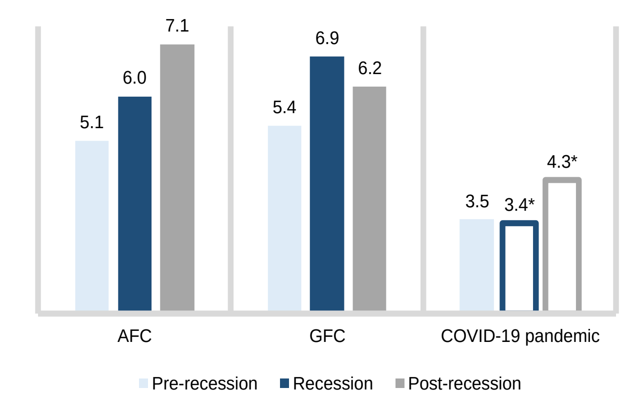
** Fiscal balance target by MoF*
Sources: MoF, CEIC

Chart 4: Government revenue growth during past crises (annual, % y-o-y)



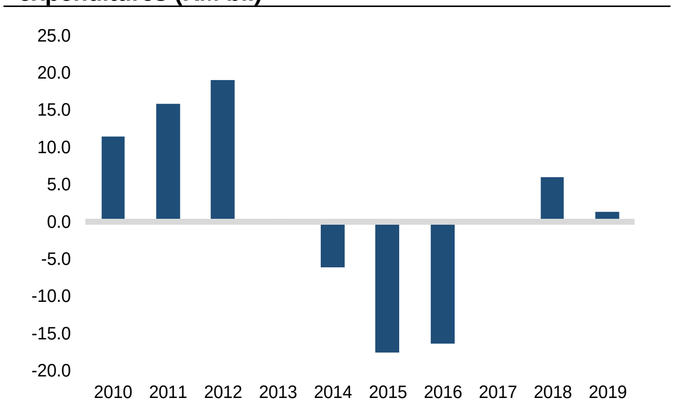
** Revenue estimates by MoF*
Sources: MoF, CEIC

Chart 5: DE during past crises (annual, % of GDP)



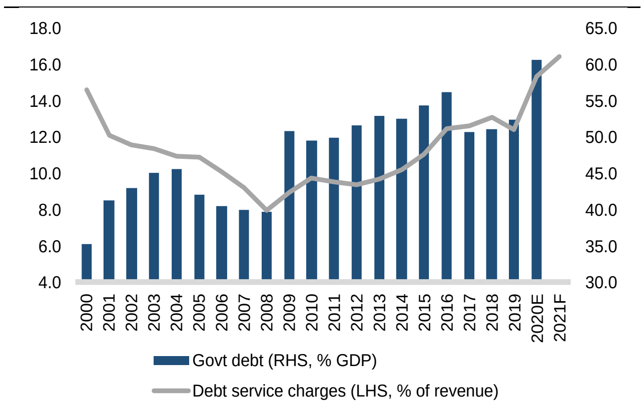
** DE estimates by MoF*
Sources: MoF, CEIC

Chart 6: Difference between actual and budgeted total expenditures (RM bil)



Sources: MoF, CEIC, MARC ERD

Chart 7: Debt service charges and government debt



Sources: MoF, CEIC, MARC ERD

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