19 October 2017

Budget 2018: Inclusive, Practical and Prudent

- *Budget 2018 will be about people's welfare and addressing future challenges. In line with the current challenging and improved economic outlook, we are expecting that Budget 2018 will focus on three main issues i.e. addressing people's wellbeing, addressing future challenges and as well as maintaining discipline and prudent fiscal spending.*
- *Rising cost of living and housing remain top of the list. People especially in the lower income brackets, namely the bottom 40% households' income group (B40 households) are vulnerable to income shock. Possible measures that possibly introduced in the upcoming budget are revision of the minimum wages, enhanced special assistance to targeted groups, tax relief, and upward revision on allowances for civil servants among others.*
- *Budget deficit target of 3.0% and 2.9% for year 2017 and 2018 respectively. Due to a broad-based recovery on global trade and better than expected performance of domestic economy, 2017 is expected to performed better than 2016. Improvement in global trade activity along with stable commodity prices amid geopolitical uncertainties, 2017 will be a relatively good year for the government as far as revenue is concern.*

Budget 2018 will be about people's welfare and addressing future challenges. In line with the current challenging and improved economic outlook, we are expecting that Budget 2018 will focus on three main issues i.e. addressing people's wellbeing, addressing future challenges and as well as maintaining discipline and prudent fiscal spending. These are three core issues which are inclusive and holistic to various segments of the society. The measures to tackle rising cost of living will be the most awaited by the people in general. In respect to rapid developments in technology and platform sharing sphere, government is expected to provide clear direction on its stance to further enhance digital economy participation. Incentive and tax issue pertaining to the businesses involved in the digital economy will likely to be address in this upcoming budget. Additionally, in line with achieving balanced budget target by 2020, discipline and prudent spending will be the key guiding principle in 2018 budget allocation.

Improved current economic conditions to benefit the people. The domestic economy has performed relatively well over the past 2 quarters in 2017. The average economic growth of 5.7% in the first half has been impressive. The domestic economy is on track to surpassed 5% target for 2017. The reflation in domestic economy is in tandem with the upswing in global trade. The momentum is expected to continue well into 2018. Additionally, stable and improved crude oil prices also provide a boost to the government's coffer. Ringgit is gradually improving amid improved external trade performance, better macro conditions and regained investors' confidence. These backgrounds provide better options for the government to tackle key focus areas affecting the people.

Table 1: Federal Government Finance

	2011	2012	2013	2014	2015	2016	2017f
Brent Oil (USD per barrel)*	110.7	111.9	108.8	99.5	53.8	45.2	52.9
Exports Growth (YoY%)*	9.3	0.9	2.5	6.7	1.5	1.3	21.1
GDP Growth (YoY%)*	5.3	5.5	4.7	6.0	5.0	4.2	5.7
Govt. Revenue (RM bn)	185.4	207.9	213.4	220.6	219.1	212.4	219.7
Govt. Expenditure (RM bn)	182.6	205.5	211.3	219.6	217.0	210.2	262.8

Source: CEIC, MIDFR
*Current performance up until first half of 2017

Rising cost of living and housing remain top of the list. People especially in the lower income brackets, namely the bottom 40% households' income group (B40 households) are vulnerable to income shock. These groups are mostly affected due to large percentage of their income are spent on necessities items. The overall rise in prices has affected the livelihood of these groups of people. Possible measures that possibly introduced in the upcoming budget are revision of the minimum wages, enhanced special assistance to targeted groups, tax relief, and upward revision on allowances for civil servants among others.

Various measures are expected to be introducing to tackle the issue of home ownership. Presently, average Malaysians are having difficulty to purchase house with median house prices going beyond their reach. Based on DOSM latest statistics in 2016, 76.3% of the houses are occupied by owner while 19.6% are living in rented properties. Housing related expenditures accounted for 24% of overall expenditure by Malaysian households. The upcoming budget is expected to both address the affordability constraints on the demand side as well as providing assistance to the developers to build more affordable houses. Possible tax exemption for building materials and related services could be on the card to drive the cost down.

Budget deficit target of 3.0% and 2.9% for year 2017 and 2018 respectively. Due to a broad-based recovery on global trade and better than expected performance of domestic economy, 2017 is expected to performed better than 2016. Improvement in global trade activity along with stable commodity prices amid geopolitical uncertainties, 2017 will be a relatively good year for the government as far as revenue is concern. In line with our anticipation of better performance for the year, we are convinced that the Government will be able to achieve fiscal deficit target of 3.0% this year. As for the fiscal consolidation plan, we are expecting that the Government will continue to strive for a lower fiscal deficit target for year 2018 at 2.9% to GDP.

Government commitment for balanced budget target by 2020. We are encouraged by the Government's resolve and commitment thus far in keeping to its deficit reduction plans. The reaffirmation of the Federal Government deficit plan for 2018 will be a confidence booster for the market, and for the Ringgit currency. MIDF maintains its view that the Ringgit is undervalued at current level and its severely misaligned vis-à-vis its fundamentals. The decision of the Government to keep to its deficit target enhances the currency fundamentals.

Government Finance

GST revenue will be slightly higher at RM42 billon in 2017. Up until the latest available data i.e. 2Q17, GST collection has been below expectation, with a total collection of RM19.3 billion in 1H17, against the expectation of RM42.0 billion for full year 2017. Presently, our estimate for 2017 GST collection is at RM42 billion. However, we expect that GST collection will continue to grow next year in anticipation of improved domestic economic environment. We estimate the full year collection of GST to be slightly higher at RM45 billion in 2018. We are also anticipating that would not be any major changes in the GST structure in this budget. However, slight changes can be expected from the list of exempted goods and services. Possible uplifting of some of the exempted goods and services from the list is possible.

Table 2: Government Revenue (RM Billion)

	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17
Govt. Revenue	48.8	47.5	56.3	59.8	46.6	50.4
Tax	39.8	36.6	44.1	48.8	37.6	39.5
Direct Tax	25.5	24.8	28.4	30.9	24.2	24.9
Corporate	11.0	18.5	12.1	16.6	13.0	13.4
Petroleum	2.0	0.9	1.9	3.6	0.8	1.7
Personnel	10.6	2.6	11.7	8.1	8.1	7.3
Indirect Tax	14.3	11.8	15.7	17.9	13.4	14.7
GST	10.2	7.1	10.8	13.2	9.2	10.1
Non Tax & Receipts	9.0	10.9	12.2	11.1	9.0	10.9
Interest & Investment Return	3.2	6.4	6.3	5.5	2.8	7.0

Source: CEIC; MIDFR

It is unlikely to be any change on the corporate tax this year, but there might be some change for the income tax. Similarly, due to the challenging economic environment that negatively impacted Government coffer, we opine there will be remote possibility of any change in regards to the corporate tax structure. However, incentives can be expected for certain targeted sectors like housing, tourism, manufacturing, digital and agricultural. In respect to personal income tax, possible positive moves for the tax payer may include among other an increase in the amount of the tax relief from the existing list. In addition, the budget may implement some temporary measures that could lift the burden of the M40 group, particularly the younger workers, such as exclusion of income tax payment for the first year of working and a slightly higher minimum income tax requirement. These possible measures will boost the disposable income of the targeted groups which in return will eventually translate into higher domestic consumption.

Economic Growth

Protecting the domestic industry. There is a rising concern regarding Malaysia's current account status, which has been showing a clear downward trend over the past few years. The downward pressure on the Ringgit due to the normalisation plan by the US central bank and other external and domestic factors in play increased the concern of policy makers on the possibility of a twin deficit next year. As such, some form of measures to protect our domestic content and reduce reliance of imported products may be introduced, or at least encouraged. Among others, there may be measures to boost tourism industry, which is regarded as an ideal sector to boost and improve our current account balance.

Table 3: Government Development Expenditure by RM Billion & Share (%)

	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17
Govt. Development Expenditure	8.8	16.6	9.5	10.6	7.5	14.4	9.4	10.8
Defense and Security	1.2	2.6	0.6	1.0	0.9	2.4	0.8	1.2
	13.2%	15.5%	6.3%	9.2%	11.9%	16.4%	8.7%	11.2%
Economic and Social	7.4	13.3	8.6	9.3	6.3	11.4	8.0	8.8
	83.5%	80.2%	90.5%	87.2%	84.1%	79.2%	84.6%	81.5%
Economic Services (ES)	5.0	8.6	6.2	6.7	4.7	7.5	5.7	6.1
	56.5%	51.5%	65.4%	63.2%	62.2%	52.3%	60.0%	56.6%
ES: Agri & Rural Development	0.9	1.1	0.6	0.5	0.5	1.4	0.6	0.3
	10.0%	6.7%	6.0%	4.4%	6.8%	9.5%	5.9%	2.4%
ES: Trade and Industry	1.0	1.4	1.6	1.7	0.5	1.0	1.4	0.6
	10.8%	8.4%	17.2%	15.7%	7.1%	7.0%	14.5%	5.9%
ES: Transport	1.5	2.1	2.5	1.7	2.0	1.6	2.1	3.5
	16.6%	12.9%	26.4%	15.8%	26.8%	11.4%	22.4%	32.8%
ES: Public Utilities	0.7	1.8	0.3	0.9	0.7	1.0	0.4	0.6
	8.5%	10.6%	3.1%	8.6%	9.3%	7.1%	4.6%	5.6%
ES: Others	0.9	2.1	1.2	2.0	0.9	2.5	1.2	1.1
	10.5%	12.9%	12.8%	18.6%	12.2%	17.4%	12.5%	10.0%
Social Services (SS)	2.4	4.8	2.4	2.5	1.6	3.9	2.3	2.7
	27.0%	28.7%	25.0%	24.0%	21.9%	26.8%	24.6%	24.9%
SS: Education	0.8	1.9	0.8	0.8	0.7	1.4	1.3	1.5
	8.5%	11.4%	8.9%	7.5%	8.9%	9.9%	13.7%	13.5%
SS: Health	0.3	0.8	0.2	0.3	0.2	0.8	0.2	0.4
	3.3%	4.9%	1.9%	2.8%	2.9%	5.5%	2.5%	3.4%
SS: Housing	0.8	0.4	1.1	0.9	0.1	0.2	0.2	0.2
	8.5%	2.6%	11.2%	8.3%	1.7%	1.2%	2.0%	2.0%
SS: Social & Community	0.6	1.6	0.3	0.6	0.6	1.5	0.6	0.6
	6.7%	9.8%	3.1%	5.4%	8.4%	10.2%	6.4%	5.9%
General Admin	0.3	0.7	0.3	0.4	0.3	0.6	0.6	0.8
	3.4%	4.2%	3.2%	3.6%	4.0%	4.4%	6.8%	7.3%

Source: CEIC; MIDFR

Stimulus to improve lending activity. There has been a clear improvement since early this year on the approved lending activity by the banks. Financial institutions have becoming more upbeat in extending facilities due to favourable economic outlook. The sectors that have been directly affected by this approach are property and auto industry. We believe there will be more measures to address the needs of first time home buyers in this coming budget. Among the possible measures are higher percentage contribution for EPF account 2 of which then be used to finance the house purchase. The measure can be implemented based on the targeted timeline of which once the contributor be able to purchase the first house, the percentage contribution will then be reverted to the previous allocation

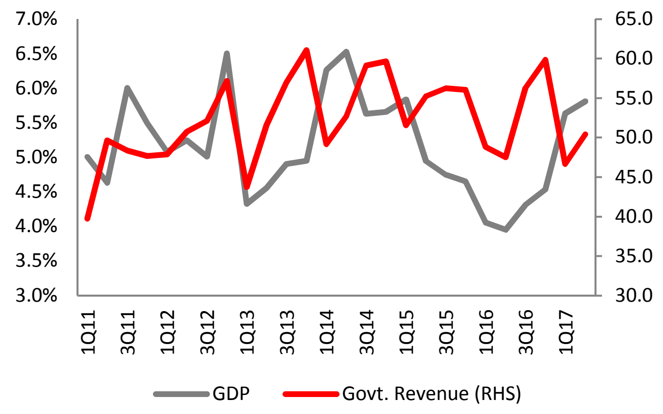
Measures to reduce dependency of foreign labour. It is inevitable that as Malaysia is moving toward becoming a high income nation. Thus, sustained dependency on cheap and low-skilled foreign labours is not within the equation. Assistance from the Government is inevitable that most businesses especially SMEs are finding it difficult to survive without relying on foreign labour. There are two possible approaches which can be adopted by the Government to resolve the foreign labour dependency, i) through providing incentives such as tax rebate to companies which shift to automation and/or mechanisation and ii) provide loans with low interest rate and longer tenure to companies seeking for financing their automation/mechanisation. To oversee this foreign labour related implementation, a clear and practical roadmap for each individual sector need to be drawn. A set of targeted timeline for the industries to gradually move toward automation is needed.

Welfare

The 1Malaysia People's Aid (BR1M) will continue to increase next year. BR1M's handout is expected to increase gradually next year for the qualified households. At the moment, 4 categories of BR1M's recipients received between RM450 to RM1200. The allocation is expected to increase from RM6.8 billion in 2017 to RM7.5 billion in 2018.

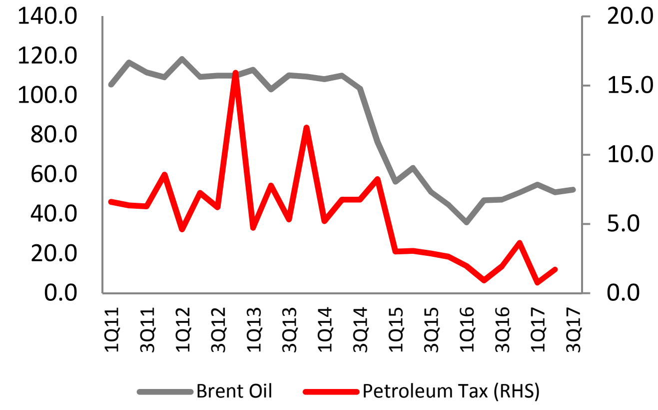
2018 is expected to be a better year for Malaysia. Subsiding external headwinds and stabilizing in commodities prices will lend supports to both domestic and external sectors. These positive developments will bode well with the anticipation of higher government revenues for 2018 as well as the smooth implementation of proposed initiatives line-up in the upcoming budget.

Chart 1: GDP Growth (YoY%) vs Govt. Revenue (RMbn)



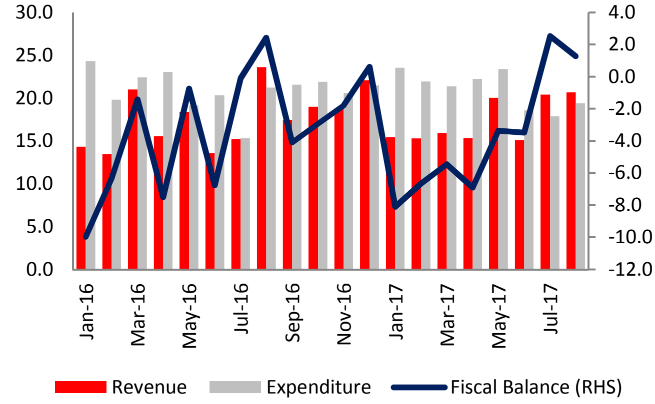
Source: CEIC, MIDFR

Chart 2: Brent Oil Price (USD per barrel) vs Petroleum Tax Revenue (RMbn)



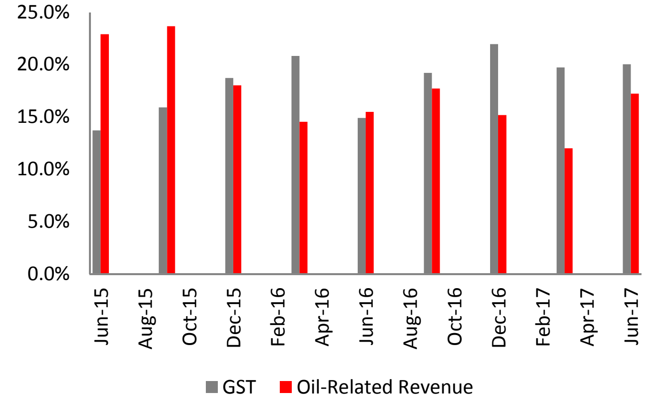
Source: Bloomberg, CEIC, MIDFR

Chart 3: Govt. Revenue vs Govt. Expenditure (RM bn)



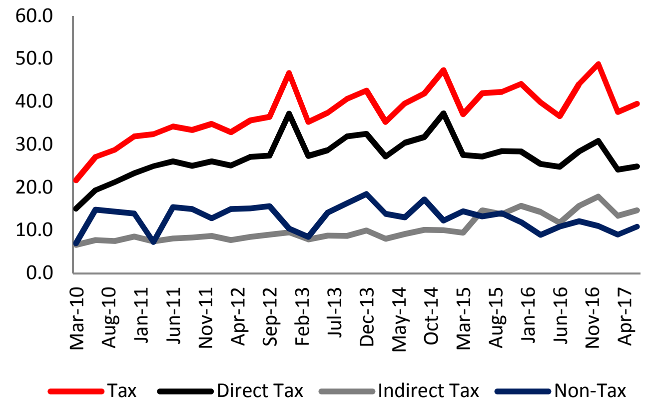
Source: CEIC, MIDFR

Chart 4: % Share of GST & Oil-Related Revenue



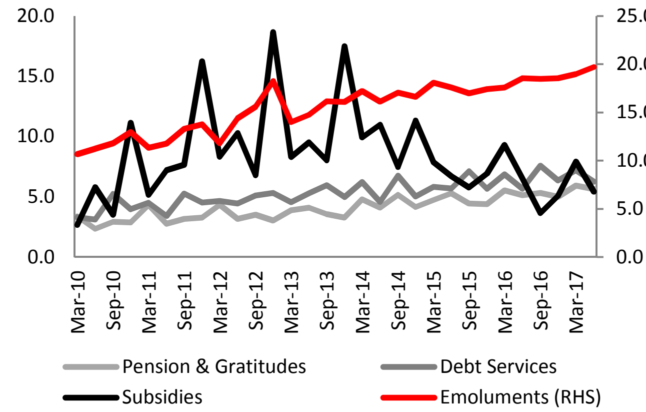
Source: CEIC, MIDFR

Chart 5: Govt. Revenue by Major Components (RM bn)



Source: CEIC, MIDFR

Chart 6: Govt. Expenditure by Major Components (RM bn)



Source: CEIC, MIDFR

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