

## ECONOMIC REPORT | Contingent Liability

### Little Risk of Sovereign Downgrade from 1MDB

- 1MDB's total debt currently stands at RM33.6 billion including the two USD1.75 billion (total: USD3.5 billion) debt, which is supposedly passed to IPIC. Of the total debts, the amount that is directly guaranteed by the Government is RM5.8 billion.
- The total amount of debts that the Government is potentially exposed to is approximately 2.87% of 2016 GDP, while the interest payment is only 0.13% of GDP. As such, even in the worst case scenario, we do not think that Malaysia's fiscal position would be significantly affected and a sovereign credit rating due to this issue is unlikely to trigger a downgrade.

**1MDB's interest payment default of USD50,312,500 was intentional.** 1MDB had defaulted on its USD50 million interest payment for USD1.75 billion bond issued by its subsidiary; 1MDB Energy (Langat) Limited, making it the first time the state-owned fund to trigger a default on its debt obligation. However, it should be noted that the default was intentional, as there is a dispute with Abu Dhabi's International Petroleum Investment Co. (IPIC) on the debt settlement. The default has triggered a cross default on another two debt obligations, amounted to RM7.4 billion (USD1.9 billion).

**Table 1: 1MDB's Debt Obligation**

Amount	Denomination	Rate	Maturity	Issuer / (Remark)	Status
1.75 billion	USD	5.75%	2022	1MDB Energy (Langat) Limited (IPIC Guaranteed)	Defaulted
2.40 billion	MYR	0.35%	2021-2024	Bandar Malaysia Sdn Bhd	Cross Defaulted
5.00 billion	MYR	5.75%	2039	1MDB (Government Guaranteed)	Cross Defaulted
1.75 billion	USD	5.99%	2022	1MDB Energy Limited (IPIC Guaranteed)	Healthy
3.00 billion	USD	4.40%	2023	1MDB Global Investments Limited (Letter of Support by Government)	Healthy
0.80 billion	MYR			Loan from Socso (Government Guaranteed)	Healthy

Source: 1MDB, MIDFR

**The total amount of debt currently borne by 1MDB is approximately RM33.6 billion.** To date, there is a total of USD6.5 billion + RM8.2 billion of long term debts left for 1MDB to oblige, leading to an approximately RM33.6 billion worth of debts. The amount of debts that has been explicitly guaranteed by the Government amounts to RM5.8 billion.

**Debt-asset swap deal between IPIC and 1MDB has not been honoured.** 1MDB has conducted a debt-asset swap deal with IPIC which involved a transfer of assets which amounted to USD4.7 billion to IPIC, while in return, IPIC would have given a cash of USD1.0 billion, take hold of two bond obligations from 1MDB with an amount of USD3.5 billion and will bear all interest payment of the two bonds with a total of USD210 million per year. As such, the defaulted USD50 million interest payments involved one of the USD1.75 billion bonds with a rate of 5.75%. It should be noted that Ministry of Finance would indemnify any financial obligation not obliged under the deal.

**IPIC will oblige the payment as a guarantor, not under the Binding Term Sheet (debt-asset swap agreement).** IPIC has mentioned in the event of 1MDB default, they would fulfill their obligation under its capacity as a guarantor and not in any capacity under the terms of the Binding Term Sheet, as they deemed their obligation under the Binding Term Sheet has been terminated due to failure of 1MDB to pay USD1.1 billion plus interest to IPIC, despite the fact that 1MDB has paid the said amount to an account as directed by IPIC earlier.

**Table 1: Maximum Amount of Contingent Liability**

Amount	Total Amount 1USD = RM3.90	Total Interest Payment Annually	Expected Nominal GDP (2016)	Total Debt to GDP ratio	Total Interest Payment to GDP Ratio
RM5.00 billion	RM35.87 billion	RM1.60 billion	RM1,249.43 billion	2.87%	0.13%
RM0.80 billion					
USD3.00 billion					
USD4.71 billion					

Source: 1MDB, MIDFR

**In the worst case scenario, the impact to Malaysia's fiscal position would be minimal.** In the worst-case scenario, where MOF would have to indemnify all debts (including those with letter of support) under 1MDB and indemnify USD4.71 billion under the Binding Term Sheet, the total amount that would be liable to MOF would be approximately RM35.87 billion which will mature in 6 to 23 years period. The amount is approximately 2.87% of 2016 GDP. The amount of interest payment annually would be approximately RM1.6 billion, equivalent to 0.13% of 2016 GDP.

**A sovereign debt downgrade due to 1MDB issue is unlikely.** We perceive that the annual debt obligation of 0.13% of GDP is relatively small, and should not impose any significant derailment on Malaysia's fiscal position. In addition, it is unlikely for the bondholders to request for early settlement, as the debts are guaranteed by the Government. Hence, we opine that the 1MDB issue would not lead to a sovereign debt downgrade.



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