Mizuho Insights: Malaysia

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MIZUHO

Budget 2021: An appropriately designed budget for a 'transition year'

In a nutshell: *Although the government expects the fiscal deficit to narrow to 5.4% of GDP in 2021 from an estimated 6.0% in GDP, the details point to a fiscal stance that is supportive of a growth recovery based on improving revenue collections and greater capital expenditure allocations. That said, there are significant risks to our forecasts stemming from an unpredictable political situation and fresh waves of coronavirus infections.*

The 2021 Budget, announced on 6 November, was characterized as a budget for "the transitional year 2021 from crisis to recovery" where the focus will shift "from broad-based support to a more targeted fiscal support…" This is achieved by allocating the higher revenue collections expected in 2021 towards development expenditures while reducing operating expenditure allocations. Even though the bottom-line suggests some fiscal consolidation to 5.4% of GDP in 2021 from 6.0% of GDP in 2020, the details point to a stance that is supportive of an economic recovery next year.

Revenue collections expected to bounce back in 2021

The 2021 Budget assumes that total revenues will grow 4.2% YoY after contracting by 14% this year. This pick-up reflects not only with the assumption that nominal GDP growth will improve from to 8.6-9.6% from -4.7% YoY in 2020 but also the expiration of certain tax exemptions that were provided this year including the deferment of tax payments for all businesses in the tourism sector until December 2020 and the postponement of tax payments from Small and Medium Enterprises (SMEs) from April to June 2020 (Figure 1). Indeed, most of the pick-up in revenue collections next year is assumed to come from tax revenues while non-tax revenues are budgeted to contract even further in 2021 compared to 2020. The deeper contraction in 2021 is explained by lower dividend contributions from Petronas and Khazanah Nasional Berhad. In an unsurprising and largely warranted move, Petronas contributed a higher MYR34bn to the governments' coffer in 2020 than was originally budgeted (MYR24bn).

Figure 1: List of tax exemptions and deferments
Deferment of tax payments for all businesses in the tourism sector until December 2020
Postponement of tax payments from April to June 2020 for SMEs
Extension of tax incentives for expenditure on machine and equipment
Stamp duty exemptions for sale and purchase as well as home financing agreement
Individual income tax reliefs on domestic travel spending
Real Property Gains Tax exemptions on disposal of properties from 1 June 2020 until 31 December 2021
Source: Ministry of Finance; Mizuho Bank

So far this year, January-to-August revenue collections have fallen 21.9% YoY and is unlikely to pick-up substantially in Q4 given the re-emergence of coronavirus cases across Malaysia. This implies that there is some risk that the government under achieves its target collections for 2020.

Expenditures directed towards development spending

The higher revenue collections expected next year are budgeted more towards capital expenditures than operating expenditures. Capex is budgeted to rise 39.2% YoY in 2021 from an estimated drop of 6.8% this year (Figure 2) and within this, allocations for the transport, healthcare and general administration sectors are higher than in 2020.

Operating expenditures, meanwhile, are projected to rise 4.2% YoY in 2021 from -13.9% in 2020 and will remain focused on paying civil servant and government employee salaries and debt servicing charges. Subsidy allocations are lower compared to 2020 reflecting lower cash program allocations which will likely offset slightly higher fuel subsidy

allocations (since the oil price assumption of USD42/barrel in 2021 is higher than USD40/barrel in 2020). Allocations under the COVID-19 fund have been reduced but remain significant to allow the economy to smoothly transition out of the pandemic.

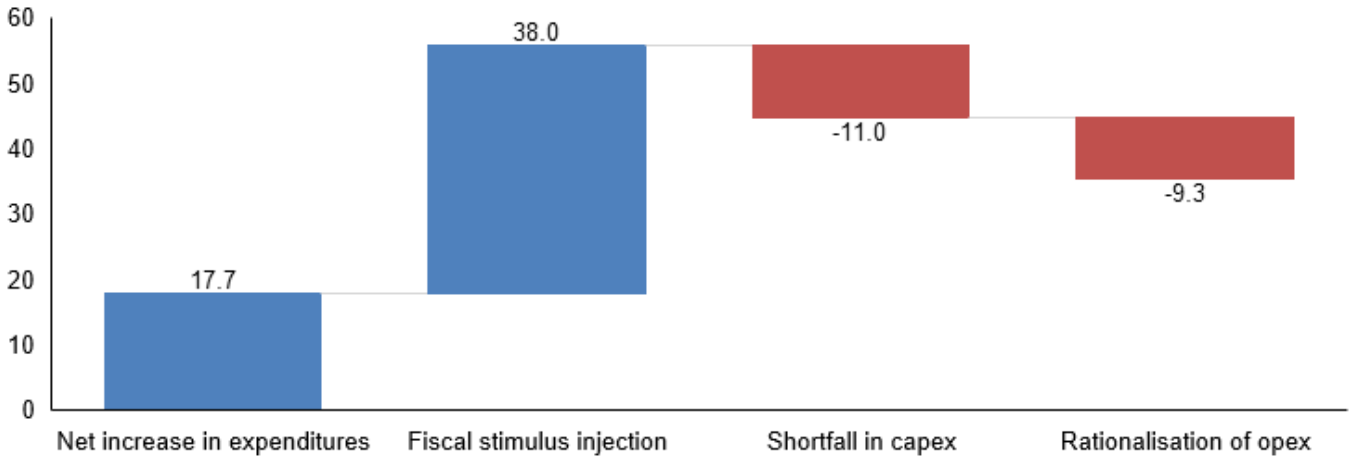
Figure 2: Budget at a glance

	2019		2020BE		2020RE		2021BE	
	MYRmn	%YoY	MYRmn	%YoY	MYRmn	%YoY	MYRmn	%YoY
Revenues	264415	13.5	244,530	-7.5	227,270	-14.0	236,900	4.2
Tax	**180566**	**3.7**	**189951**	**5.2**	**153260**	**-15.1**	**174370**	**13.8**
Direct	134723	3.6	142676	5.9	115105	-14.6	131870	14.6
Indirect	45843	4.1	47275	3.1	38155	-16.8	42500	11.4
Non-tax	**83849**	**64.0**	**54579**	**-34.9**	**74010**	**-11.7**	**62530**	**-15.5**
Petronas dividend	54000	184.2	24000	-55.6	34000	-37.0	18000	-47.1
Expenditures	317,516	10.9	297,020	-6.5	314,720	-0.9	322,540	2.5
Current expenditures	**263343**	**14.0**	**241,020**	**-8.5**	**226,720**	**-13.9**	**236,540**	**4.3**
Emoulments	80534	0.7	82611	2.6	82611	2.6	84532	2.3
Subsidies	23901	-13.1	24186	1.2	20145	-15.7	18853	-6.4
Debt service charges	32933	7.8	34945	6.1	34945	6.1	39000	11.6
Others*	45557	367.3	9019	-80.2	8437	-81.5	9574	13.5
Net development expenditures	**52570**	**-4.9**	**55,234**	**5.1**	**49,000**	**-6.8**	**68,200**	**39.2**
Gross development expenditures	54173	-3.4	56,000	3.4	50,000	-7.7	69,000	38.0
Less Loan recoveries	1603	103.4	766	-52.2	1,000	-37.6	800	-20.0
COVID-19 Fund	n.a.		n.a.		38,000		17,000	
Central government fiscal balance	-51498		-51,724		-86,450		-84,840	
%GDP	**-3.4**		**-3.2**		**-6.0**		**-5.4**	

*Source: Ministry of Finance (MOF); Mizuho Bank. *In 2019, the others component included a one-off MYR37bn spend in tax refunds*

The large YoY drop in 2020 expenditures takes into account the one-off MYR37bn in tax refunds; excluding which, the revised estimate for operating expenditures in 2020 is similar to the actual 2019 spend. Expenditures have fallen by 0.4% YoY from January to August 2020 and will need to by ~10% lower in the remainder of the year to achieve the government's revised 2020 target. Notwithstanding, there remains enough support for growth through increased resources from the COVID-19 fund, expenditure rationalization through lower subsidy spend and a reallocation of capex funds (Figure 3).

Figure 3: Expenditure rationalisation and reallocation of capex helps cap expenditure increase in 2020



Debt ceiling limit likely to be raised

The government raised its statutory debt ceiling limit to 60% of GDP from 55% of GDP in September. While the statutory

limit is only applied to MGS, MGII and MITB, for which, the debt to GDP ratio stood at 56.6% of GDP as of end-September; total federal government debt was 60.7% of GDP. While the nuances of the statutory debt ceiling limitation would suggest that the government has technically not yet breached its recently revised self-imposed limit, the fact that federal debt is already above 60% of GDP suggests to us that it is only a matter of time before the government will have to raise it debt ceiling limit again (possibly to 65% of GDP), especially if the pandemic continues to hit in waves. Despite this, given that close to all of the borrowings for 2020 were from domestic rather than external sources and this will likely remain the distribution in 2021, we see limited risks of any rating actions (i.e., a downgrade) as exchange rate risks are contained.

Political risks and COVID realities

Even as the 2021 budget aims to strike the right balance of having to transition the economy out of a pandemic induced crisis and fiscal prudence, there are significant risks around the outcomes. The immediate risk is political as the budget stands to become the long awaited litmus test for the Muhyuddin government to prove (or fail to prove) its parliamentary majority. Parliamentary alliances have so far been volatile and fluid making it hard to judge if the budget will be approved by the legislature. Any delays in passing the budget will pose significant downside risks to an already fragile recovery.

The threat of a resurgence in coronavirus cases is another big risk. Lacking a permanent solution, fresh waves of coronavirus infections threaten to derail growth prospects via the imposition of lockdowns and/or greater social restrictions and Malaysia is no exception, experiencing a second wave of infections that started in September. To that end, we continue to believe that there is significant uncertainty surrounding the fiscal deficit forecasts for 2020 and 2021 with the government forced to step in to bolster growth when fresh waves of infection hit. For 2021, specifically, these risks can manifest as lower-than-budgeted revenue collections and a significant reallocation of capex towards operating expenditures and pandemic relief (as was the case in 2020).

Monetary policy and exchange rate implications

The broadly supportive fiscal stance will complement Bank Negara Malaysia's (BNM) dovish bias in bolstering an economic recovery. We expect BNM will lower its policy rate further by 25bp next year – additional rate cuts will depend on the severity of coronavirus outbreaks as headline inflation remains benign. At any rate, BNM continue to provide liquidity and credit support to households and businesses as a first port of call to avoid significant and potentially, irreversible balance-sheet damage.

Following the budget announcement, MYR strengthened further against the USD on Friday with USDMYR closing last week around 4.12 levels. MYR strength was further supported by the election of Joe Biden as US President. Without a surge in US Treasury yields to revive sustained and sharp rebound in USD strength, we expect USDMYR to end 2020 at ~4.10 from the current 4.12 levels. And with a mellower USD trend set to be reinforced by an accommodative Fed stance, we expect MYR traction to be retained by and large; subject to spurts of headline/political risks. On the whole, MYR support will come from vaccine positives that the boost demand narrative and buoy oil prices. Volatility, however, remains a main stay given the propensity for headline risks.

	Q3 2020	Q4 2020	Q1 2021	Q2 2021	Q3 2021	Q4 2021
GDP (% y/y)	-12.1%	-10.6%	-1.9%	12.9%	6.0%	5.6%
Policy Rate (%)	1.75%	1.75%	1.50%	1.50%	1.50%	1.50%
USD/MYR*	4.1565	4.10	4.16	4.03	4.12	4.08
	4.10-4.29	4.08 - 4.18	4.08 - 4.22	3.98-4.18	4.00 - 4.25	4.02-4.22

Source: CEIC; Mizuho Bank