5 November 2018

ECONOMIC HIGHLIGHTS: BUDGET 2019

Budget 2019 – A Resurgent Malaysia, A Dynamic Economy, A Prosperous Society; the government envisions to achieve this by implementing institutional reforms, ensuring the socio-economic well-being of Malaysians, and to foster an entrepreneurial economy.

	Unit	2017	2018F Revised	% Change 2018F	2019B	% Change 2019B
Real GDP Growth	**%**	**5.9**	**4.8**		**4.9**	
Revenue	RMbn	220.4	236.5	7.3	261.8	10.7
Operation Expenditure	RMbn	217.7	235.5	8.2	259.9	10.4
Operating Balance (surplus)	RMbn	2.7	1.0	-62.7	2.0	94.5
Gross Development Expenditure	RMbn	44.9	54.9	22.3	54.7	-0.4
Loan Recovery	RMbn	1.9	0.6	-69.6	0.7	16.5
Net Development Expenditure	RMbn	43.0	54.3	26.3	54.0	-0.5
Fiscal Balance	RMbn	**-40.3**	**-53.3**	**32.2**	**-52.1**	**-2.3**
Fiscal Balance	% of GDP	**-3.0**	**-3.7**		**-3.4**	

Source: Ministry of Finance (MOF)

The Ministry of Finance ("MOF") projects the country's real GDP growth of 4.8% year-on-year ("yoy") in 2018, implying a slower growth of 4.7% in 2H18, from 4.9% in 1H18. For 2019, MOF expects real Gross Domestic Product ("GDP") growth to increase to 4.9%, supported by healthy domestic demand.

Government revenue is projected to be higher by 7.3% to RM236.5bn this year and increase further by 10.7% to RM261.8bn in 2019, while operating expenditure is also expected to increase by 8.2% in 2018 and 10.4% in 2019. The overall fiscal deficit is projected to widen to RM53.3bn or -3.7% of GDP in 2018 (initial budget 2018: RM39.8bn) and improving to RM52.1bn or -3.4% of GDP in 2019. The fiscal consolidation expected to be on track helped by special dividend from Petronas paying off the one-off tax refund.

The government will undertake a more rigorous expenditure optimization exercise to avoid wastage and leakages of government spending, where among the priority measures i) streamline functions of ministries and agencies; ii) scaling down and ceasing of projects with low priority and low multiplier effect; iii) improving government procurement policy. This also shows the government's strong commitment towards fiscal consolidation.

Private consumption will continue to be the key driver of growth

Government is expecting the private consumption to be supported by stable employment outlook, favourable labour market, increase in the minimum wage and targeted government assistance.

- Minimum wage to increase to RM1,100 effective from Jan 2019.
- Bantuan Sara Hidup ("BSH") cash grants restructured with allocation of RM5bn, with additional allowances for children, benefiting a total of 4.1m households.
- Fuel subsidies, which cost RM3bn in 2018F, will decline to RM2bn in 2019B as the government reverts to a managed float fuel pricing mechanism with targeted fuel subsidies, effective from 2Q19, for individual car owners with engine capacities of 1,500cc or less (up to 100 litres of RON95 per month) and motorcycle owners of 125cc or less (up to 40 litres of RON95 per month) with subsidies of at least RM0.30/litre.
- Government subsidies electricity usage of poor and hard core poor households with electricity bill less than RM20 with a plan to increase to RM40.
- The government will spend RM150m to equalise the price differential of critical goods between urban and rural areas in Peninsula Malaysia, Sabah and Sarawak. This includes wheat flour, processed sugar, cooking oil in 1kg packs, local rice with 15% broken grains in 10kg packs, RON95, diesel and liquid petroleum gas ("LPG").
- One-off assistance of RM500 to pensioners who are receiving pensions of less than RM1,000.
- Government abolish tolls for motorcycles for Penang Bridge, Second Penang Bridge and Malaysia Singapore Second Link.
- Government to freeze toll rate hikes for all city highways in 2019.
- Introduce unlimited travel pass at RM100 which includes rail services and RapidKL bus services starting 1 Jan 2019.

Implications of Budget 2018 on Malaysia Market

Equity Market

Under an already challenging backdrop of lowered IMF growth of 3.7% for 2018 from 3.9%, rising prospect of a full-blown trade war between the US and China, and a hawkish US monetary policy, the Malaysian government has revised down Malaysia's GDP growth for 2018 from 5.0%-5.5% to 4.8%, and for 2019 a growth of 4.9% yoy.

Revenue for 2019 of RM261.8b inclusive of a special Petronas Dividend of RM30b which will be used to pay GST and income tax refunds. As such oil related revenues for 2019 of RM51.2b will jump by 48% from RM33.6b in 2017, and RM37.8b in 2018. If this jump is a one off as indicated to help pay off the tax refunds owing, it would be considered prudent all things considered. However, some rating agencies have voiced their concern of Malaysia's growing reliance on oil revenues rather than having policies to widen the tax base.

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Whilst the Budget's focus on the B40's disposable income is in line with expectations, and this will help sustain consumer demand. The sugar tax is more of a deterrent and to try to change people's behaviour in manufacturing full sugar drinks. Hence, we expect the consumer sector to remain resilient. The hardest hit was the gaming sector which saw a higher than expected duties imposed in an already highly taxed environment. Other sector impacts seemed fairly neutral despite some aspects of trying to level the playing field from foreign service providers, or higher operational costs from minimum wage hikes.

With clarity lacking for some of the measures but investors have assumed the worst, stock prices have taken a hit. We expect this sort of volatility to continue as a result of domestic politics, policies, and also made more challenging with external noises from the ongoing US-China trade war, US monetary policy, and volatilities in oil prices. Many of these things are out of our control, and we have to remain focused on companies that have strong fundamentals and a good track record of thriving even in challenging environments.

Bond Market

The Government is committed on its plan for a long-term fiscal consolidation while improving transparency. As such, this "one-off" pressure should subside after 2019 as the government plans to reduce fiscal deficit further to 2.8% of GDP by 2021.

On the supply side, the upward revision to the budget deficit also means that the Government will need additional funding of around RM11-13billion in 2018, bringing the estimated total Malaysian Government Securities ("MGS")/ Malaysian Government Investment Issue ("MGII") issuance to around RM110-115billion for 2018. Furthermore, MGS/MGII issuances is expected to increase around RM120billion in 2019. The larger supply of sovereign bonds may create a surplus pressure in the market, but we expect domestic sovereign bond market to remain supported by ample liquidity.

Overall, we expect to see some volatility in the Malaysian bond market in the near term amidst higher interest rates in the United States of America. That said, any knee-jerk reaction from the budget announcement may provide some buying opportunity. In the longer term, with (1) higher government bond issuances, (2) higher inflation forecast of 2.5% - 3.5% in 2019, and (3) the Fed's monetary tightening, we maintain our view that sovereign bond yields are likely to experience some upside bias.

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