BBVA Research

Malaysia

Economic Watch

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Economics Analysis

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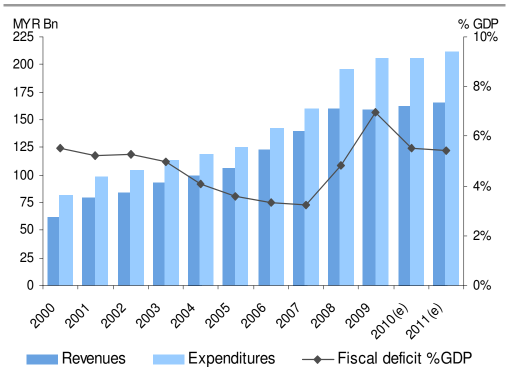
Malaysia’s 2011 budget

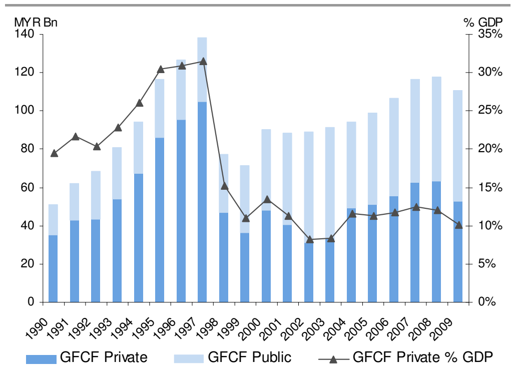
- Malaysia recently unveiled its 2011 budget proposal, the key annual economic policy announcement. The budget is particularly focused on boosting public-private investment initiatives.
- The government plans a modest increase in public expenditure in 2011, with the fiscal deficits falling slightly to 5.4% of GDP. As such, the fiscal stance is still broadly supportive of growth.
- The budget is financeable, given huge liquidity in the banking system, high domestic savings and current account surplus.
- The absence of a concrete fiscal consolidation plan over the medium term is somewhat of a concern, but there is adequate time to address it given that public debt levels are still modest (by OECD standards).
- Market reaction to the budget has been reasonably positive, as the parameters of the new budget were largely in line with expectations.
- Despite capital inflows, the scope of further currency appreciation is limited by export slowdown and intensifying intervention by the central bank.

Chart 1
A declining fiscal deficit for 2011



Source: BBVA Research and Ministry of Finance, Malaysia

Chart 2
Private investment in Malaysia has been low in the last decade



Source: BBVA Research and Ministry of Finance, Malaysia

Malaysia unveils its budget plan for 2011

Fiscal outturn in 2010

The Federal government's fiscal deficits for 2010 is estimated at 5.6% of GDP (vs. 7.0% in 2009), which is in line with original budget plan. Government expenditure totalled MYR205.5 billion (26.1% of GDP) and was higher than originally planned (MYR188.9 billion) because of faster growth in operating expenditure (in particular emoluments, supplies and services, and subsides). The extra expenses were covered by higher revenues (up 2.2% vs. original plan of -6.4%) from stronger economic growth (we expect GDP will grow by 7.2% this year) and higher oil prices.

Reducing the structural deficits in the medium term still a difficult task

A key concern is on how to reduce the deficit over the medium-term as oil production (which represents one-third of total revenues) is expected to decline in the coming years. The government has vowed to reduce its fiscal deficits to 2.5-3.0% by 2015. Government expenditure has fallen to 26.1% of GDP in 2010, in line with pre-crisis levels, but still among the highest in Asia. New long-term initiatives aiming to boost public-private projects have been launched this year, in line with the Vision 2020 (see below) which plans to invest USD444 billion over next ten years. It is still uncertain whether it could help to attract private capital, and improve the productivity, and thereby tax revenue growth of the country. On the revenue side, over one-third of government revenues are related to oil – sales tax, company profit tax, royalties and export tax. With oil production expected to decline, it is imperative for the government to explore new sources of revenue in the future to finance its spending. On this count, introduction of the goods and services tax (GST), originally planned in 2011, would have been helpful. The GST may have been postponed due to political priorities ahead of the general election in 2013.

Vision 2020 and Budget plan in 2011

The government has recently launched a series of policies called Vision 2020 to attract private investment domestically and from aboard, retain talent, strengthen public service delivery, and enhance people's quality of life, all in order to increase long-term growth potentials of the country, and turn Malaysia into a high-income country (USD15.000-20.000 per capita) by 2020. These policies are included in the:

- Government Transformation Programme (GTP) through the 6 National Key Results Areas: crime, corruption, education, poverty, rural basic infrastructure, and public transport. (Launched in January 2010)
- Economic Transformation Plan (ETP), with the 12 National Key Economic Areas: financial services (including Islamic Finance), business services, agriculture, information and communication technology, palm oil, private healthcare, electronics, education, oil and gas, tourism, wholesale and retail, Greater Kuala Lumpur. (Launched in March 2010)
- 10th Malaysian Plan, acting on the GTP and the ETP to establish macroeconomic growth targets, and expenditure allocation. (Launched in June 2010)

In 2011, the government plans to increase its expenditure by 2.8% to MYR212 billion, with the fiscal deficit falling only slightly by 0.2 ppt to 5.4% of GDP (MYR45.5 billion). This is partly due to the launch of several initiatives within the programs mentioned above (emphasizing some private/public projects). Operating expenditure is projected to rise by 7.0% to fulfil the 10th Malaysia Plan commitments. Development expenditure will fall by 9.0% as the stimulus package since 2008 (totalled 67 billion) is wearing off. The government expected that revenues will climb by 2.3% in 2011 on the back of stronger expansion in domestic and external economic activity and higher commodity prices. The government assumes 5-6% GDP growth in 2011 (BBVA Research: 5.0%) and, a higher production of natural gas (6.1%, compared with 5.2% in 2010) and crude oil (1.3%, compared with -2.6% in 2010).

With lower deficits and debt redemption requirements, gross financing needs in 2011 (MYR64.9 billion) will be smaller than in 2010 (MYR93.9 billion). Around 57% of total gross borrowing will be through the issuance of Malaysian Government Securities. Financing should be a small issue because (1) huge liquidity in the banking system should be able to absorb most of the new issues; (2) there are no external financing problems as Malaysia still runs a hefty current account surplus, and external debt currently represents 2.3% of GDP (3) federal government debt as of 2010 was around 52.7%, which is well below OECD average level of 95% of GDP.

Table 1
2011 Budget highlights

KL International Financial District (MYR26 billion)
Mass Rail Transport for greater KL (MYR40 billion)
Increase in number of hospitals/clinics/equipment (MYR15 billion)
Schools (MYR6.4 billion)
Warisan Merdeka, 100 storey tower (MYR5 billion)
Development of economic corridors (MYR850 million)
Low cost housing (MYR568 million)
Freeze in some toll rate hikes for the next 5 years.
1% increase in service tax to 6% in some services.
Total abolition of import duty on some 300 branded items.
Stamp duty discount for first time home buyers.
What we also expected…
New Good and Services Tax
Personal income tax cuts
Reduction of dividend on Real Estate Investment Tax
Higher excise duty on alcohol

Effectiveness of new measures still an open question

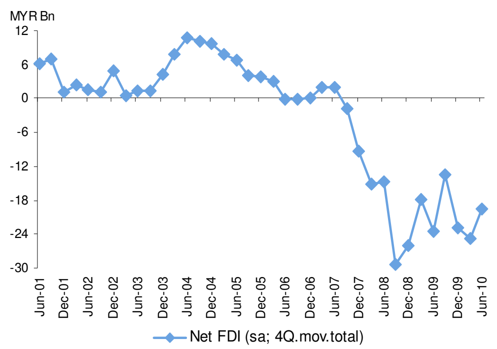
The 2011 budget plan and these new policies are steps in the right direction. Malaysia’s GDP growth in the past decade has been relatively sluggish by historical standards (4.7% vs. 7.2% in the 90’s), with private investment averaging only 10% of GDP (vs. 25% in the 1990s). Foreign investors were not enthusiastic in making long-term investment, with net FDI contracting persistently on a downward trend. The policies outlined above aimed at improving the investment environment (e.g. MYR1 billion in the Facilitation Fund for private-public partnership projects in 2011) and retaining talent (establishing a Talent Corporation program) to boost long-term productivity growth. The 2011 budget has addressed the needs of hardware infrastructure sufficiently, but other issues related to productivity, competitiveness and labor skillset are still to be resolved. Hence it is still too early to judge if they are effective in boosting investor’s confidence and long-term growth prospects.

MYR will likely be driven by export performance and BNM’s intervention

The long-term structural deficits will unlikely have material implications on the MYR in the near term, as the fiscal deficits in the next few years should be able to be easily financed. The market is waiting for further evidence on sustained increases in foreign investment inflows before taking a more bullish stance. In the near term, the outlook of MYR will likely be determined by the country’s external performance and the attitude of the central bank (BNM).

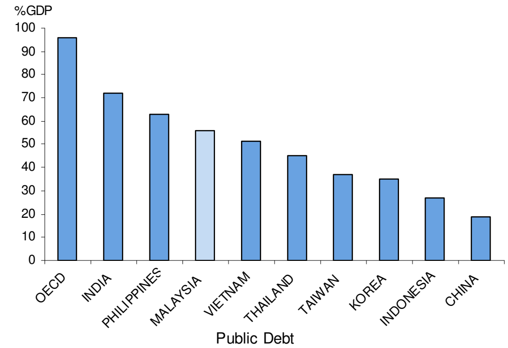
In this regard, the scope for further MYR appreciation may appear to be limited, as BNM appears to be uneasy when MYR-USD falls below 3.10. In retrospect, MYR appreciated significantly against the dollar in February as BNM hiked rates surprisingly. Since then economic recoveries and expectation of further rate hikes kept MYR appreciating against the dollar broadly at the same pace as SGD-USD. It is important to note that forex reserves during this period did not increase, indicating limited intervention by BNM. But the situation changed in September – forex reserves have increased by USD5.4 billion as MYR-USD fell below 3.10. Meanwhile, BNM has also held policy rate unchanged since August. We believe the intervention reflects BNM's concerns about export competitiveness at current level of exchange rate, especially given slowing industrial output and exports. Baring from further USD weakness, we expect MYR-MYR could retrace to 3.10-3.15 by year-end. Steady growth in external demand in our baseline forecast keeps us neutral on MYR in 2011.

Chart 3
Net FDI is declining, adding concern on future economic sustainability



Source: BBVA Research and Ministry of Finance, Malaysia

Chart 4
Public debt is relatively low by OECD standards



Source: BBVA Research and IMF

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