Economy

AMB

Malaysia: Government - path to fiscal consolidations

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- The Federal Government is set to register a larger-than-projected fiscal deficit this year than in 2008. In fact, it will be the largest in 12 years since 1998.

- When the 2009 Budget was presented in August 2008, the Government had proposed an allocation of RM203B (+5.0% from the revised 2008 allocation). With revenue projected to increase at a faster 10.0% to RM176B - on the back of real GDP forecast of 5.4% - the deficit could narrow to 3.6% of GDP or RM26.8B.

- A noble intention indeed on the part of the Government to consolidate its finances. It had successfully reduced the deficit from 5.5% of GDP in 2000 to 2.7% in 2007. The 2008 shortfall of 4.8% was exceptional as the Government had to step in to soften the impact of upswing in the global oil price on Malaysians.

- Since the Budget presentation, however, the world has turned upside down.

- The Government responded by introducing two stimulus packages. The first, announced late last year, involving an additional spending of RM7B. The second, introduced in March this year, involving a sum of RM60B (split over 2009/2010), of which only RM15B was in the form of fiscal injection. The balance was in the form of guarantee funds, equity investments, private finance initiative (PFI) and off-budget projects, as well as tax incentives.

- Taking into account all these fiscal measures – and along with monetary policy responses - the Government was hoping that Malaysia could be spared from falling into a deep recession. Real GDP growth was therefore envisaged at –1.0% to +1.0% for 2009. The higher expenditure, however, means that the budget deficit would swell to 7.6%.

- The revised growth forecast, however, proved unachievable. As global economic situation deteriorated further, unavoidably Malaysia's real GDP turned negative, sharply at an annualized rate of 6.2% in 1Q09.

- Inevitably also, overall growth for the entire year was revised downwards to a more sensible -5.0% to -4.0%, the upper-case of which matches our own projection.

- The sharper downward revision of the real GDP would only means a larger shortfall in revenue collections that would push the overall deficit larger than the 7.6% of GDP anticipated earlier.

- Even if we assume revenue to stay flat at RM160B that was achieved in 2008, the additional spending from the two stimulus packages would result in the fiscal deficit ballooning to 8.5% of GDP or about RM57B this year. On the other hand, if the 2009 revenue were to remain at RM176B under the original 5.4% real GDP forecast, the deficit could narrow to RM41B or 6.1% of GDP.

- Inescapably, in whatever scenario, Government debt would certainly increase substantially this year from the RM306B or 41.5% of GDP recorded last year. In 1997, it was only one-third of the 2008 level at RM90B or 32% of GDP.

- Notwithstanding, debt service charges as a proportion of operating expenditure and revenue remained at manageable levels of about 8-9%.

MALAYSIA: FEDERAL GOVERNMENT FINANCES (2000-2008)

	Revenue	Expenditure	Current Surplus/Deficit	Net Development Expenditure	Overall Surplus/Deficit	
	RMB				RMB	% of GNP
2000	61.9	56.5	5.3	25.0	-19.7	-5.5
2001	79.6	63.8	15.8	34.2	-18.4	-5.2
2002	83.5	68.7	14.8	35.1	-20.3	-5.3
2003	92.6	75.2	17.4	38.3	-20.9	-5.0
2004	99.4	91.3	8.1	27.5	-19.4	-4.1
2005	106.3	97.7	8.6	27.3	-18.7	-3.6
2006	123.5	107.7	15.9	35.0	-19.1	-3.3
2007	139.9	123.1	16.8	37.5	-20.7	-2.7
2008	159.8	153.5	6.3	41.9	-35.6	-4.8
2009 - Original #	176.2	154.0	22.2	49.0	-26.8	-3.6
2009 - Revised ##	160.0	154.0	6.0	63.5	-57.5	-8.5

Source : Bank Negara Malaysia & Department of Statistics Malaysia

- Additionally, the larger part (93%) of the overall 2008 debt was in the form of domestic debt as the Government continued to repay foreign borrowings (outstanding at only RM18B or USD5B in 2008, possibly lower than the foreign debt of many corporations) in the absence of new commitments form external markets and governments.

- It is in this light – low exposure to risks associated with foreign borrowings - we do not think the recent downgrading of Malaysia's long-term currency rating from "A+" to "A" by Fitch Ratings (due to concern over the country's growing budget deficit) would have a major impact on the country and the economy. (The rating downgrade by Fitch is the first since the onset of the global financial crisis, but Standards and Poor's, and Moody's had yet to review or announce their ratings.)

- Given the large excess of domestic liquidity (around RM270B is presently placed with Bank Negara), and the excess of national savings over investment (as reflected by the large surplus in the current account of the balance of payment), funding fiscal deficit through the selling of debt securities in the domestic market is a non-issue, not even from the international markets or institutions.

- Indeed, it may even be necessary for the Government to issue more debt securities to satisfy the statutory and non-statutory needs and expanding portfolio of financial institutions like Employees Provident Fund, banks and insurance companies.

- Borrowings, from domestic market in particular, to satisfy development expenditure – and not for operating expenditure – is acceptable so long it is within prudential limits and capability to repay. Borrowings from international market, if its done by the Government would be more for benchmarking purposes rather than needs (as has been done before).

- In our view, while the Government debt at present is at a manageable level and this year's ballooning deficit is critically necessary to cater for the extraordinary circumstances, going forward it needs to seriously consolidate and bring public finances back on a sustainable trajectory, more so after twelve years of shortfalls.

- The feasible pace of fiscal consolidation will depend to a considerable extent on the degree to which economic growth is restored in 2010 and beyond.

- While the Government had recently indicated its desire to narrow the fiscal gap in the coming year, we on the other hand, believe that fiscal deficit inevitably would have to remain wide in 2010 as fiscal support would remain necessary to shore up or to sustain the still-fragile economic conditions, domestically and externally.

- Beyond 2010, we think it is highly desirable for the Government to reinforce fiscal prudence and rebuild policy buffers against future global shocks. In order to be able to do this, and as a first priority, we think the main engine of growth, namely the private sector, should be rejuvenated and inflow foreign investment re-encouraged and revitalized.

- While the recently-unveiled equity liberalization measures for the 27 services sub-sectors and the soon-to-be announced moves (end-June in conjunction with Invest Malaysia 2009 Conference as hinted by many) would help propel the country to a higher plane, the Government certainly needs to do more towards achieving the growth and employment (and socio-economic) objectives.

- Perhaps the 2010 Budget - to be announced in August/ September - would contain more measures and incentives to put the domestic private sector on the growth track and encourage greater inflow of foreign direct investment.

- The only caveat is, with the huge excess capacity that the Malaysian economy (world-wide phenomenon actually) is currently experiencing, new capital spending by the private sector at best would probably only shows up in 2011!

- In the meantime, the burden for next year would again have to be shouldered more by the fiscal arm of the Government alongside with its monetary arm.

MALAYSIA: FEDERAL GOVERNMENT OUTSTANDING DEBT (2000-2008)

	Total Debt			Domestic		Foreign	
	RMB	% YOY	% of GDP	RMB	% share	RMB	% share
2000	125.6	12.0	35.2	106.8	85.0	18.8	15.0
2001	145.7	16.0	41.3	121.4	83.3	24.3	16.7
2002	165.0	13.2	43.0	128.7	78.0	36.3	22.0
2003	188.8	14.4	45.1	151.5	80.2	37.3	19.8
2004	216.6	14.8	45.7	182.0	84.0	34.7	16.0
2005	228.7	5.6	43.8	198.7	86.9	30.0	13.1
2006	242.2	5.9	42.2	217.2	89.7	25.0	10.3
2007	266.7	10.1	41.7	247.1	92.7	19.6	7.3
2008	306.4	14.9	41.5	286.1	93.4	20.3	6.6

Source : Bank Negara Malaysia & Department of Statistics Malaysia