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SOCIO-ECONOMIC RESEARCH CENTRE

Malaysia in Transition: Policy Challenges and Opportunities

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Key Messages

GLOBAL ECONOMY HAS PEAKED, RISING RISKS

EVALUATING THE RISKS UNDERMINING GLOBAL OUTLOOK

REBUILDING NEW MALAYSIA

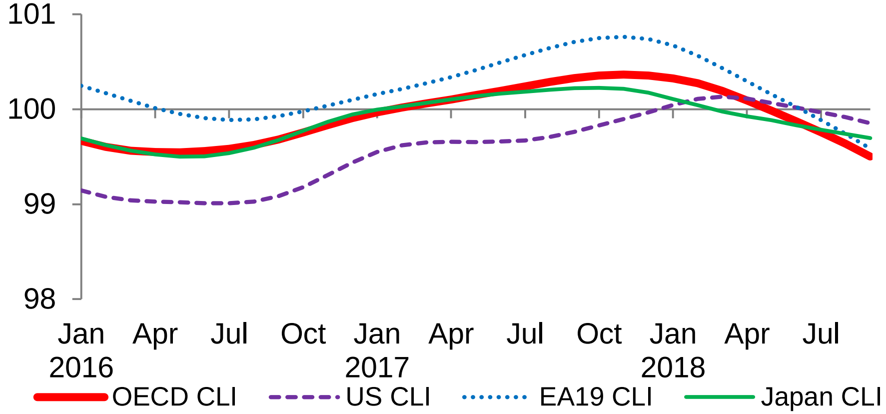
Section 1

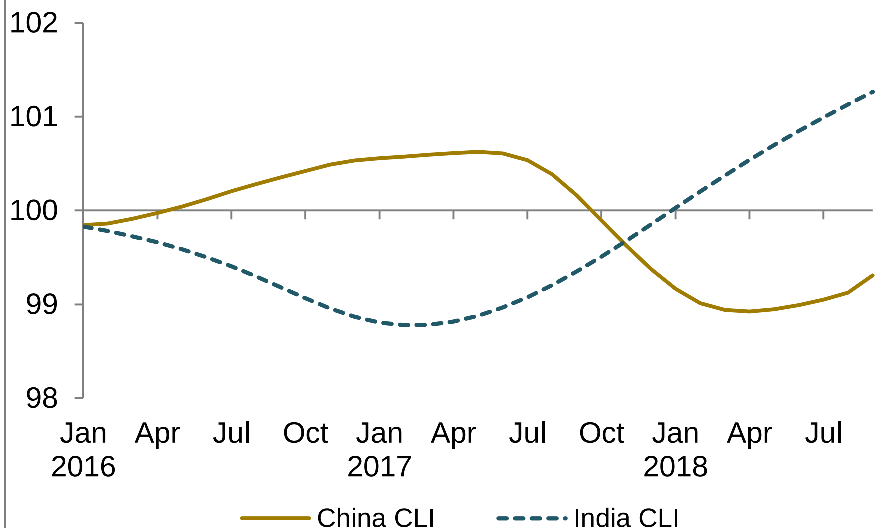
Snapshot of Global Indictors –

Uneven expansion, downside risks to growth

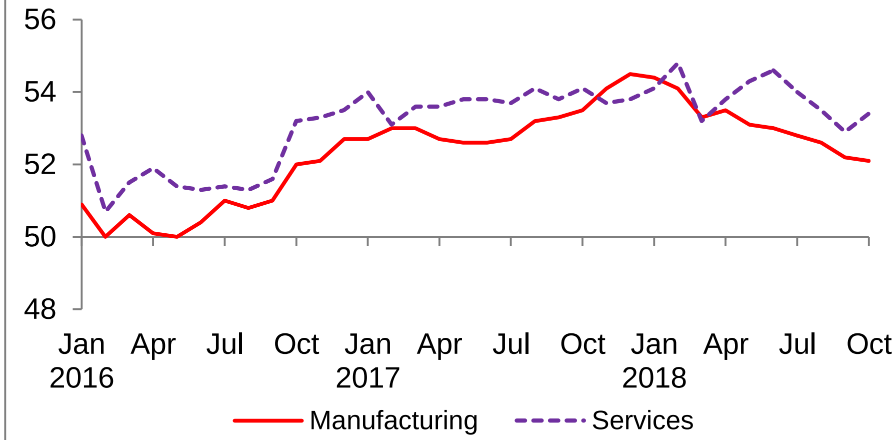
Global indicators show growth PEAKING and is slowing

Composite Leading Index – a gauge of economic outlook
(Long-term average = 100)

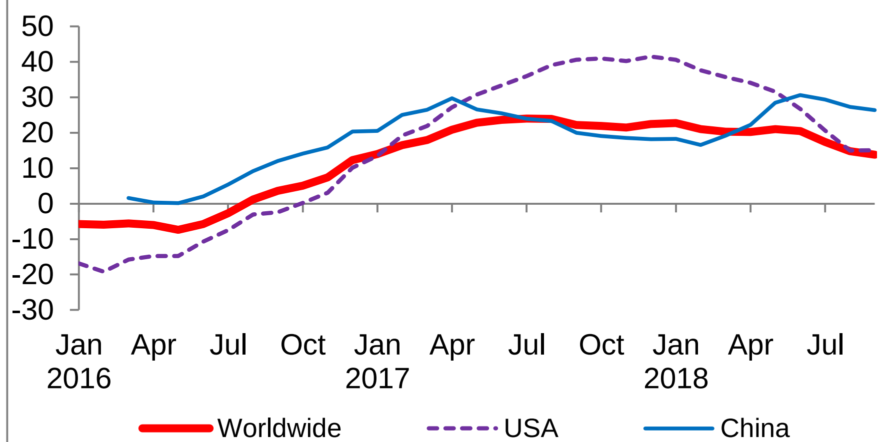




Global PMI for manufacturing and services
(50 = no change on prior month)

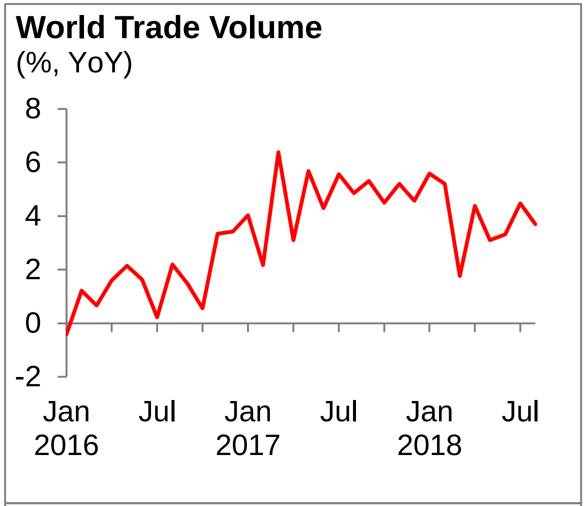


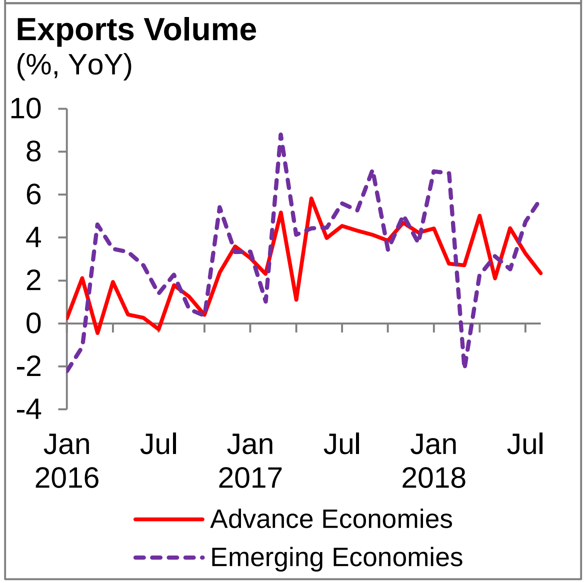
Global semiconductor sales
(%, 3-month moving average YoY)



Source: OECD

Global TRADE still on positive trajectory, but …





Source: CPB, Netherlands

… there are unintended consequences from tit-for-tat trade war. The repercussions are highly disruptive and damaging on global economic growth via trade and financial channels.

Trade channel

Curtail trade activity; Asian supply chains disruption and dampen global growth

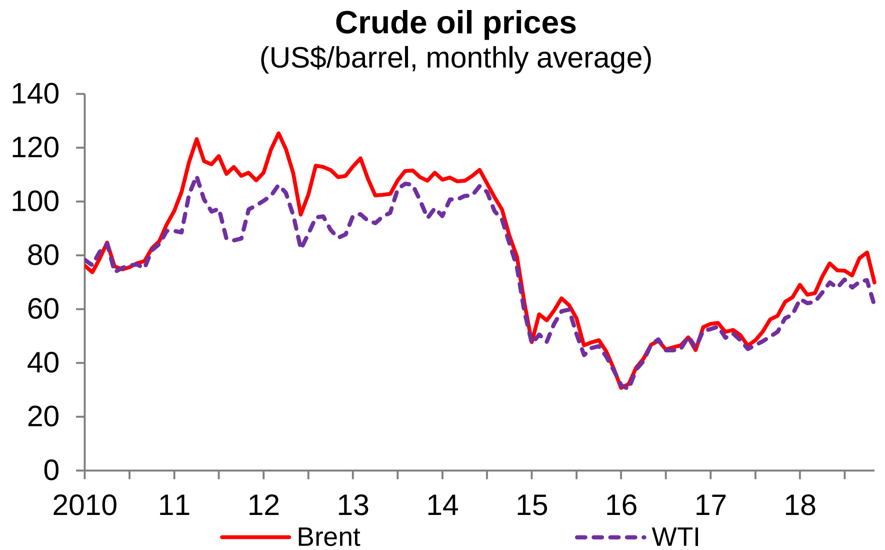
Financial channel

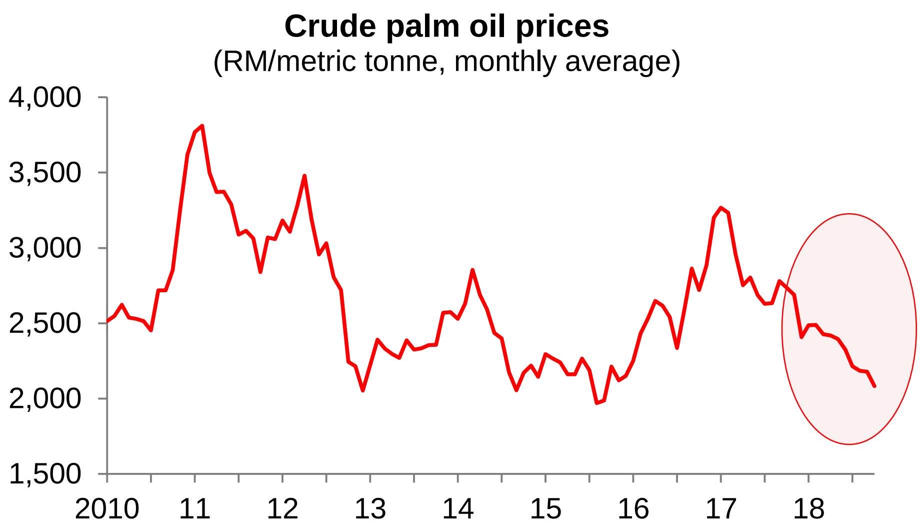
Share prices of affected companies / industries will be rerated on earnings concern

In Sep 2018, WTO revised trade growth projections lower to 3.9% (from 4.4%) in 2018 and 3.7% (from 4.0%) in 2019

Sustained trade tensions could slash Asia's economic growth by up to 0.9 percentage point in coming years

Crude oil price REVERSES the uptrend, CPO price DOWNTREND continues



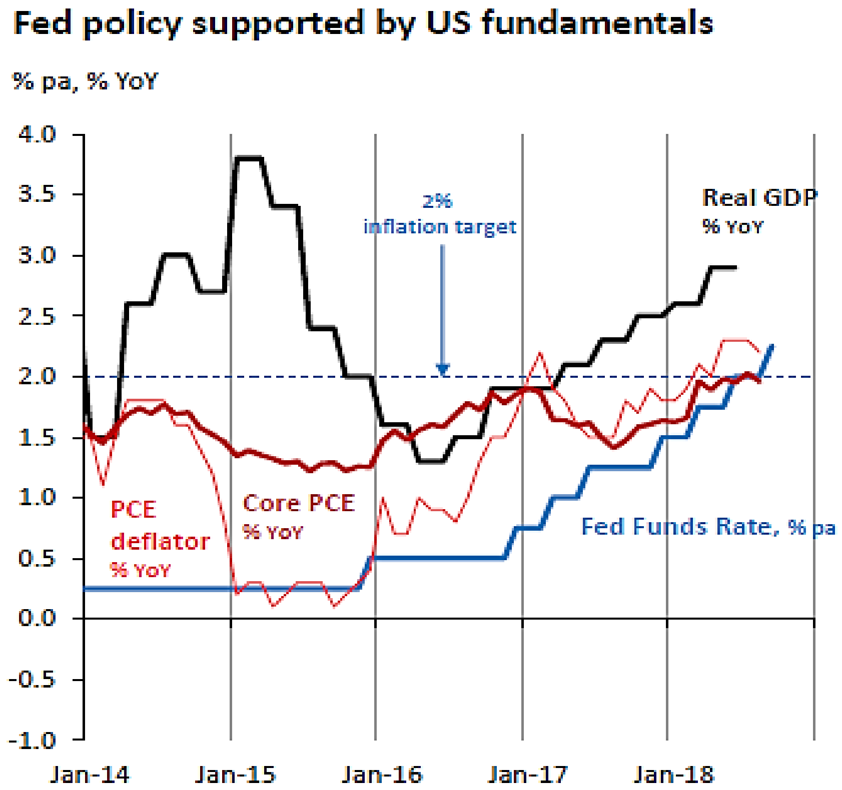


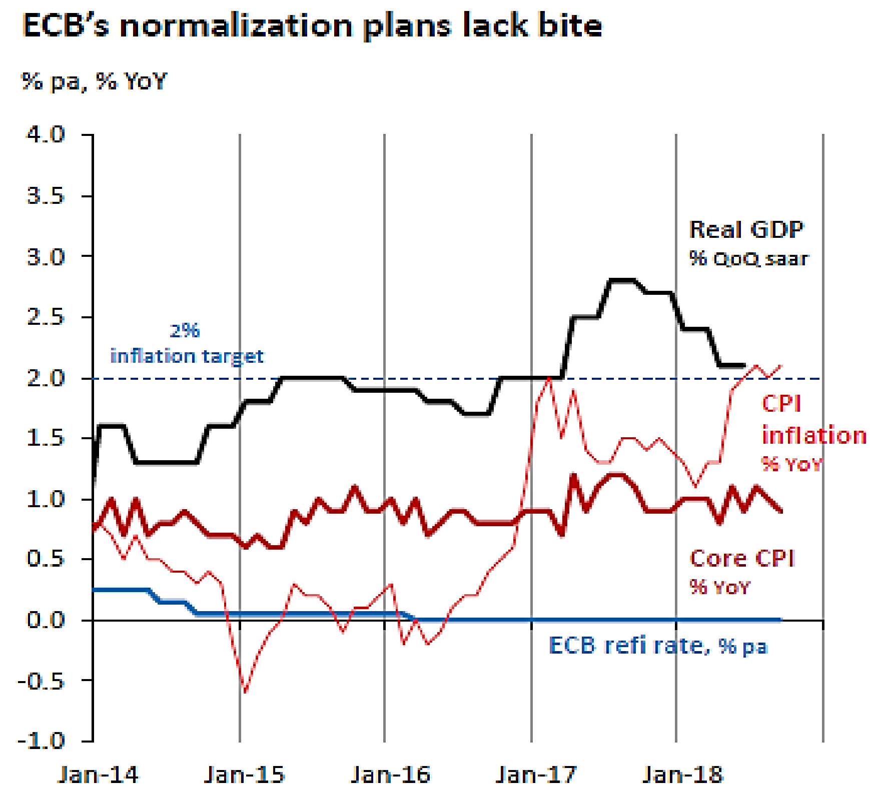
Source: EIA; MPOB

- **Crude oil prices:**
  - ❑ Surpassed US$80/barrel in end-Sep but dropped below US$70/barrel recently (US$65/bbl as at 13 Nov).
  - ❑ **Downside risks**: Trade tensions, slower global economic growth, higher OPEC output, stronger than expected Canadian and US production.
- **CPO prices:**
  - ❑ High palm oil inventory in Malaysia and Indonesia. Stocks are piling up since May.
  - ❑ Soybean planting in South America.
  - ❑ Higher import tariffs imposed by India.
  - ❑ Proposed ban on the utilization of palm oil as biodiesel in Europe starting 2021.

Growth, inflation and interest rates RISING together

- Based on the Fed's guided rate path, the Fed funds rate will rise to **2.25-2.50% by end-2018** and **3.00-3.25% by end-2019** respectively.

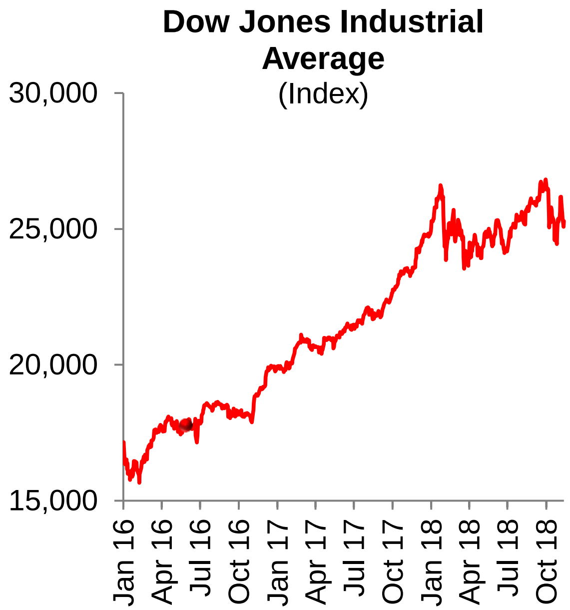




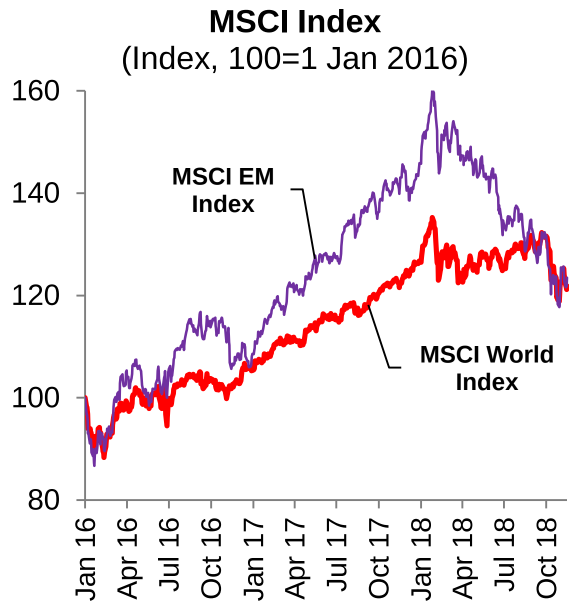
Source: DBS

Global equity markets recorded MIXED performance

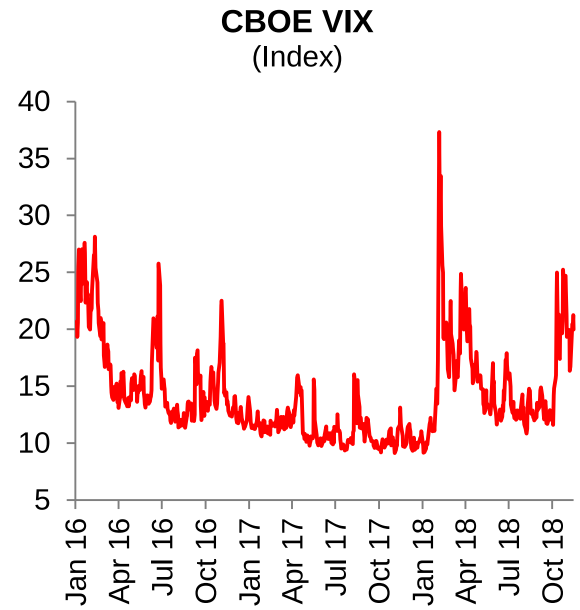
The DJIA is hitting record highs…



…emerging markets falling into bear territory

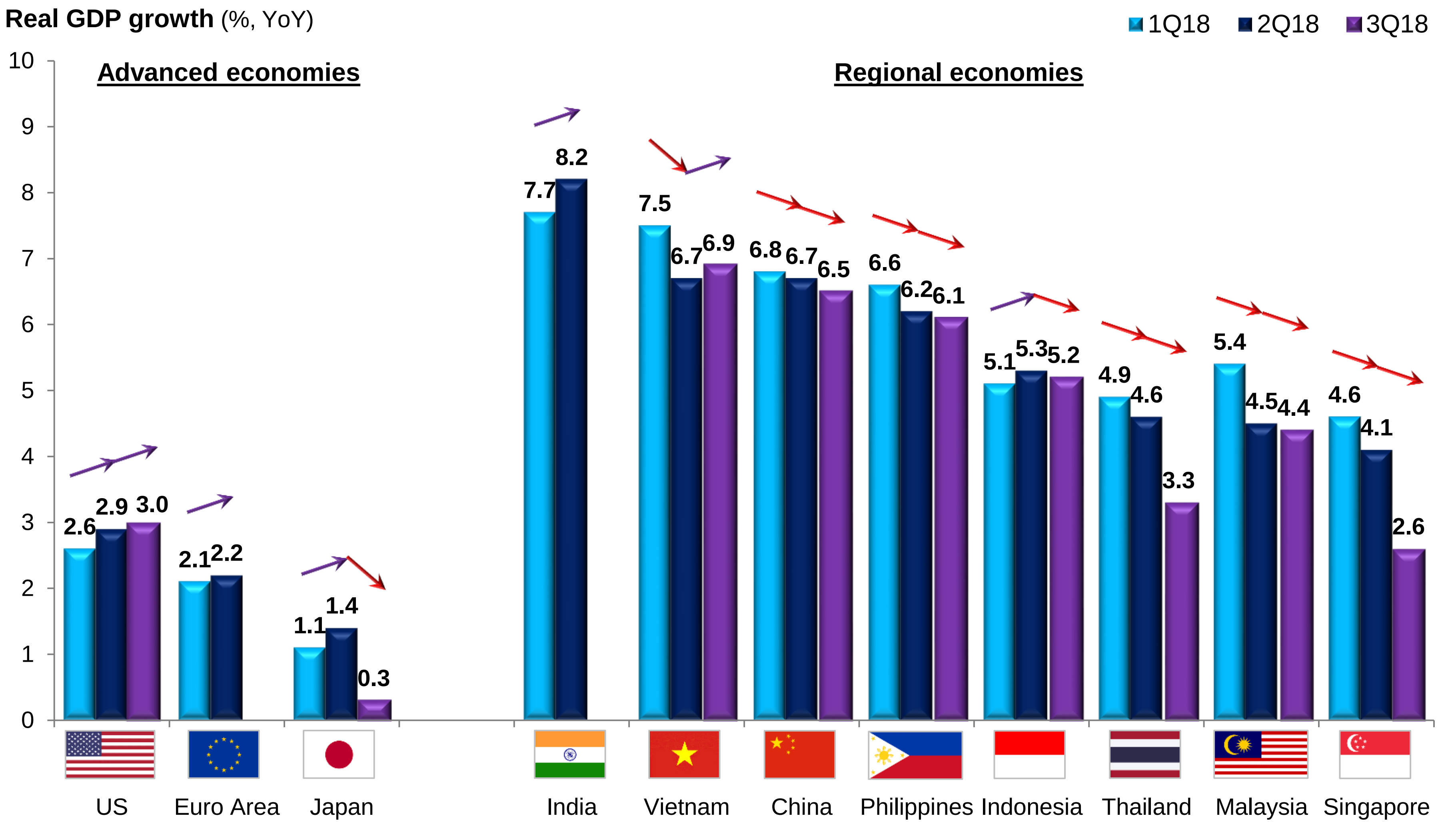


The 'fear index' indicates some uptick



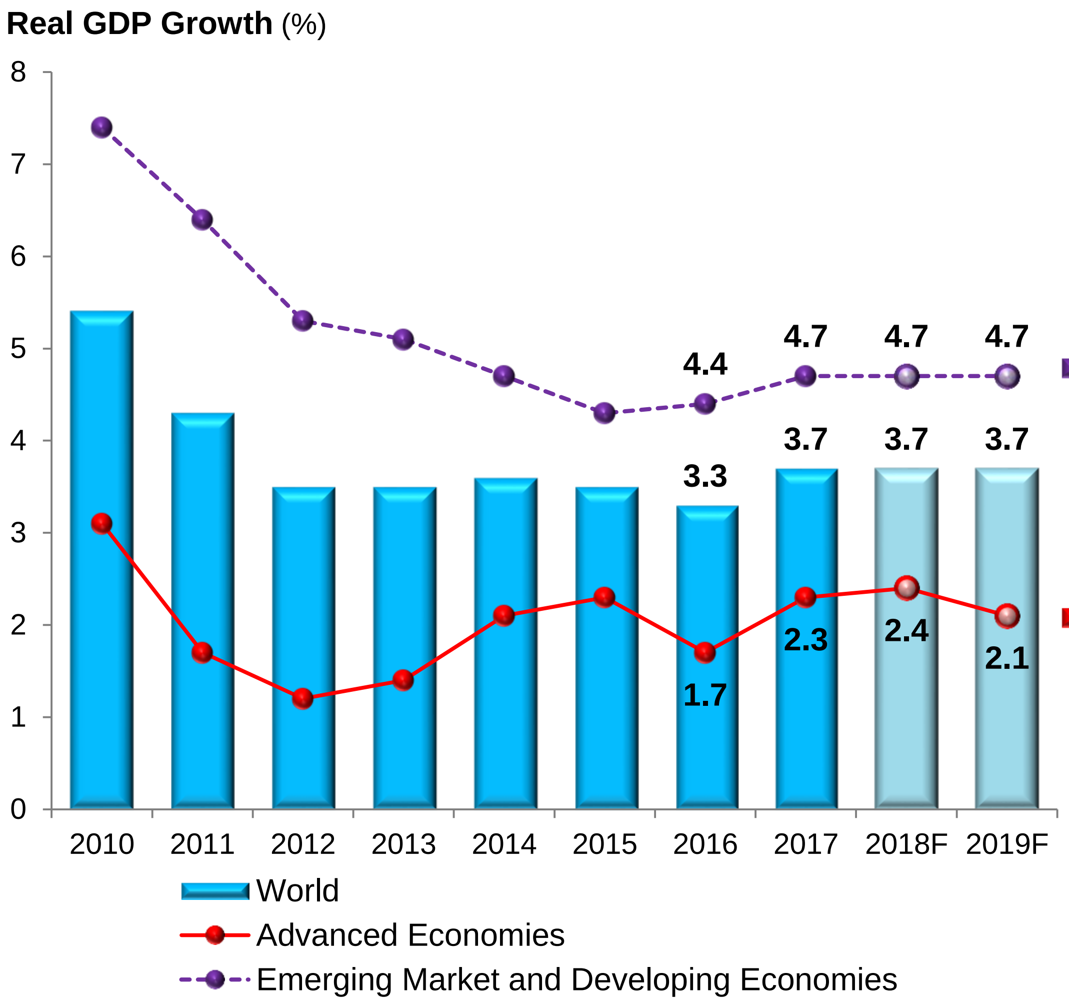
Source: WSJ; MSCI; CBOE

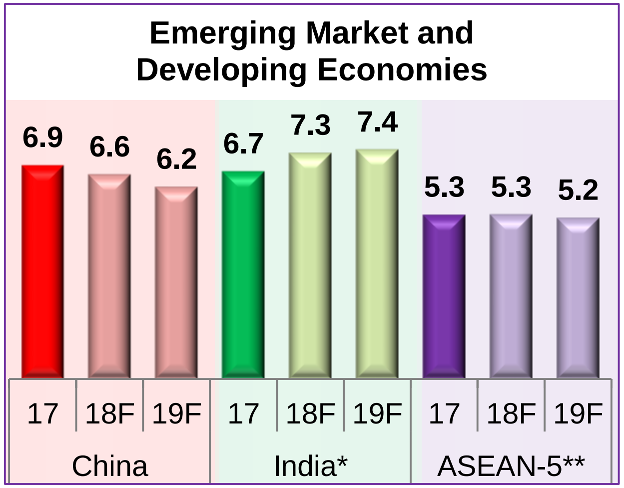
Uneven EXPANSION in advanced and regional economies

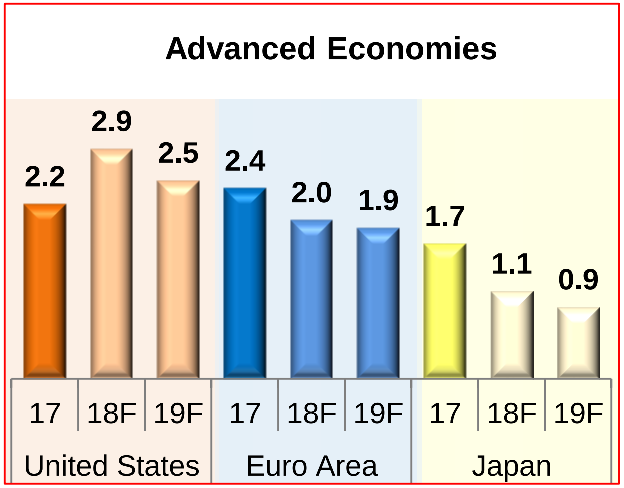


Source: Officials

GROWTH prospects for advanced and emerging economies







Source: Officials; IMF (WEO, October 2018)

* *Annual GDP for India is on fiscal year basis*

** *ASEAN-5: Malaysia, Indonesia, Philippines, Thailand, Vietnam*

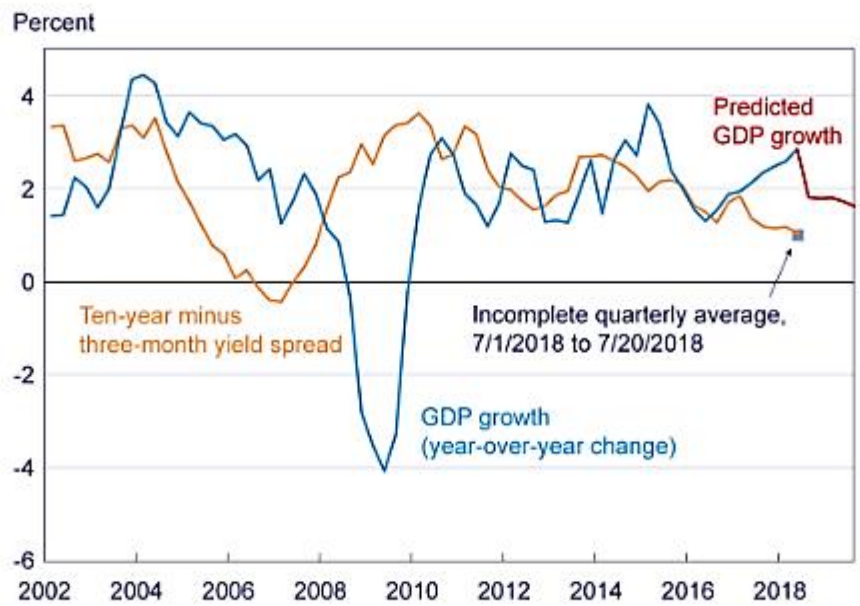
US GROWTH will decline once parts of its fiscal stimulus go into reverse

Source: Bloomberg

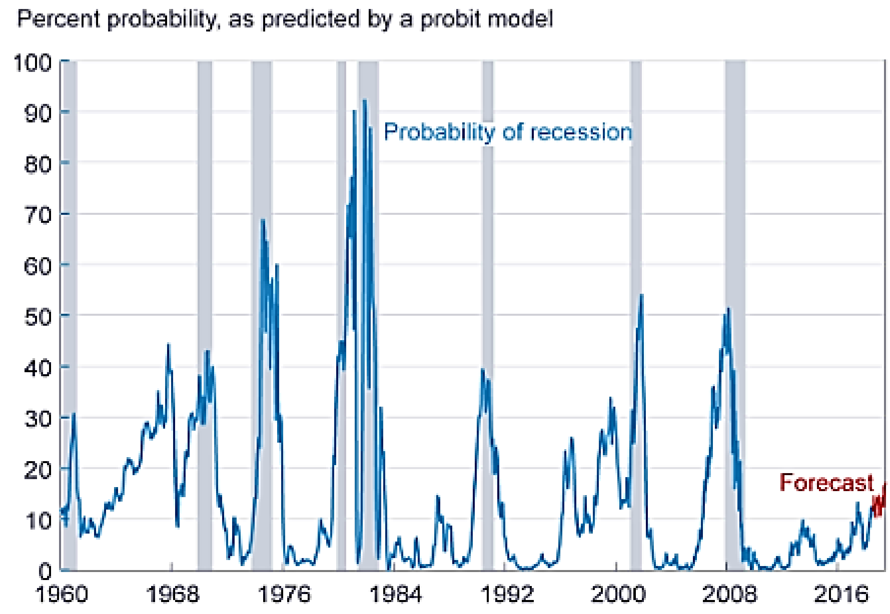
Is INVERTED US yield curve is a harbinger of ECONOMIC TROUBLE?

- The rule of thumb is that **AN INVERTED YIELD CURVE** (short rates above long rates) indicates a recession in about a year, and yield curve inversions have **PRECEDED EACH OF THE LAST SEVEN RECESSIONS**.
- **FLIGHT TO QUALITY AND SAFETY**. The Fed and central banks around the world have been buying up government debt for years, effectively depressing long-term interest rates.

Yield-Curve-Predicted GDP Growth



Sources: Bureau of Economic Analysis; Federal Reserve Board; authors' calculations.



Note: Shaded bars indicate recessions.
Sources: NBER, Federal Reserve Board; authors' calculations.

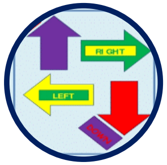
Section 2

Risks to Global Growth –

Growing downside risks

Global economy still GROWING but MULTIPLE RISKS ahead

Global growth has **MATURED** and **PASSED ITS PEAK**. **INCREASING DOWNSIDE RISKS** to growth over next 18 months.



UNEVEN EXPANSION and **LESS SYNCHRONIZED** in advanced economies and emerging Asia.

"**FIVE RISKS**" increase **global uncertainty**:

1. TRADE WAR

Spillover effects, escalation & uncertainty

2. RISING US INTEREST RATES

3. FINANCIAL VOLATILITY

4. INTENSIFIED RISKS IN EMERGING MARKETS

5. POLITICAL AND GEOPOLITICAL RISKS

Next GLOBAL RECESSION – What will trigger and when?

First, US's fiscal-stimulus effects **RUNNING OUT OF STEAM**.

Second, with inflation rising above target **PUSHING THE FEDERAL FUNDS RATE TO AT LEAST 3.5%** by 2020. By then, other central banks would have normalized interest rates; reduce global liquidity and put upward pressure on interest rates and the US dollar.

Third, the Trump administration's **ESCALATING TRADE SPATS** with China and other trading partners, leading to slower growth and higher inflation.

Fourth, other countries will retaliate against US protectionism. **CHINA'S GROWTH** will be challenged by continued deleveraging; highly vulnerable emerging markets will be significantly pressured by capital reversals.

Fifth, GLOBAL EQUITY MARKETS ARE GETTING FROTHY. US P/E ratio is 50% above historical average, steep market valuations, government bonds are too expensive. Global debt has hit another high (US$247 trillion, exceeding 318% GDP at end-Mar). Some of the US$3.7 trillion in debt taken on in the ten years since the 2008-09 Global Financial Crisis.

THE EXPANSION IS NINE YEARS OLD. AN ILL-TIMED END OF FISCAL STIMULUS, CORPORATE DEBT BUBBLE AND THE TRADE WAR ARE THE POWERFIRES THAT COULD MOST EASILY END IT

Section 3

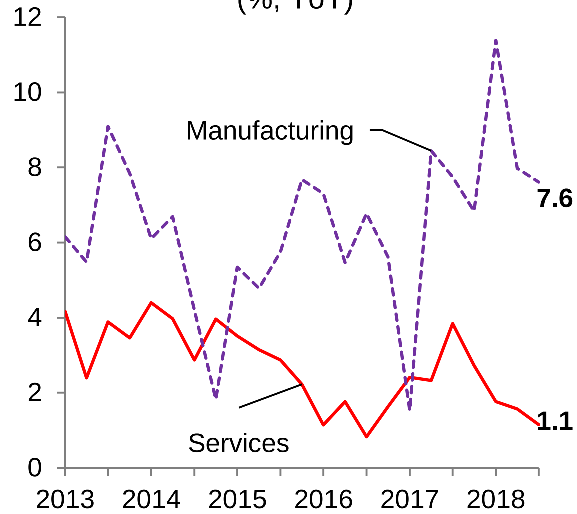
Domestic economic conditions:

Challenging Transition for New Malaysia

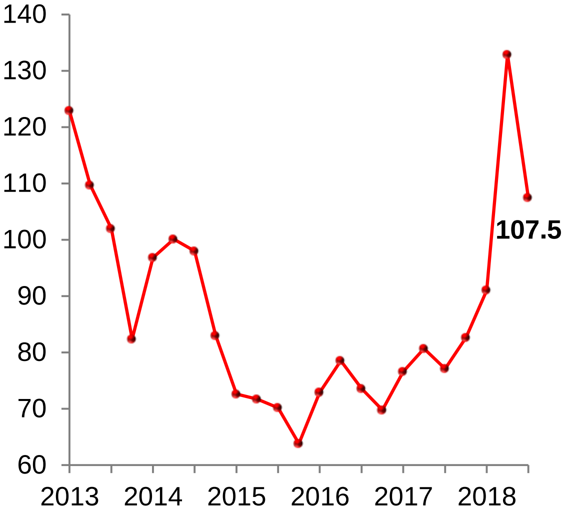
SOLID consumer spending but will it normalise?

- **FUNDAMENTAL DRIVERS**: Income growth and labour market conditions
- Household spending will **NORMALIZE** post 3-month zerorised GST tax holiday and the introduction of **SST** on 1 Sep
- Potential **DAMPENING FACTORS**: Review of fuel subsidy and cost of living aid

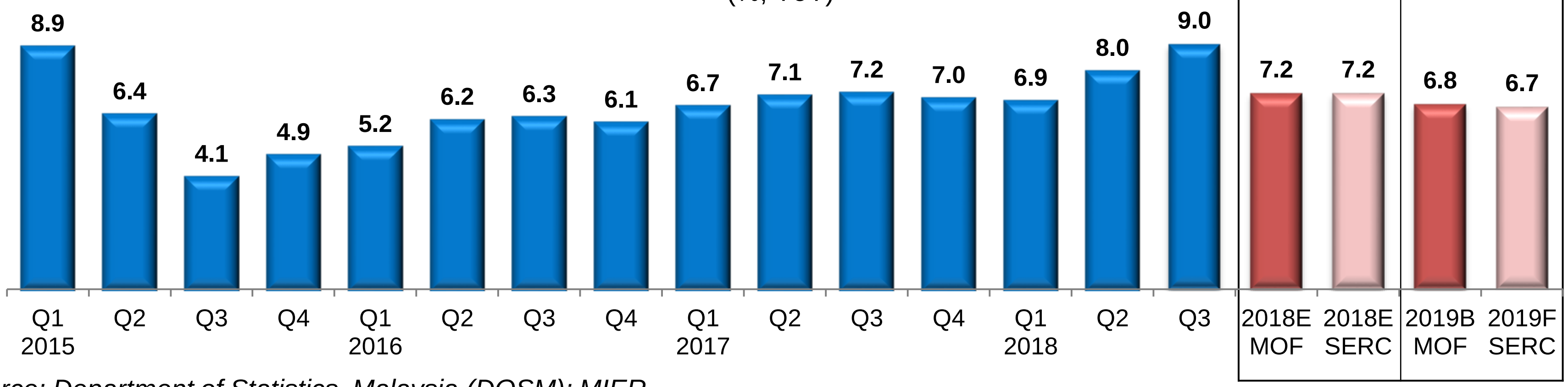
Private Sector's Employee Income
(%, YoY)



MIER Consumer Sentiments Index (CSI)



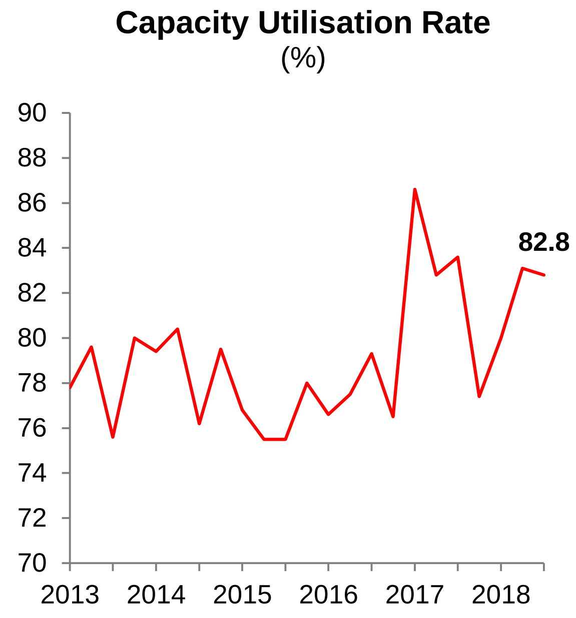
Private Consumption Growth
(%, YoY)

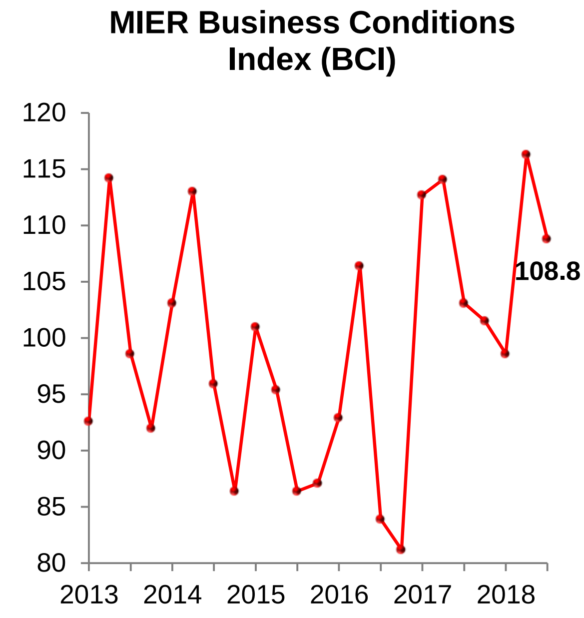


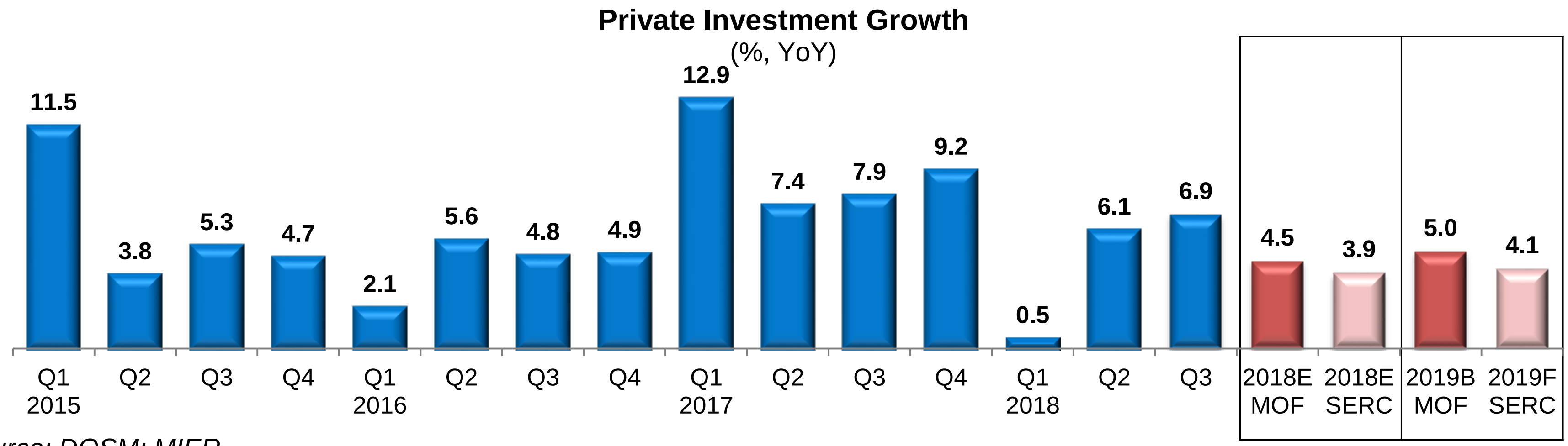
Source: Department of Statistics, Malaysia (DOSM); MIER

Private investment growth ON TRACK but CAUTIOUS

- Private investment growth **ON TRACK** to 6.9% yoy in 2Q (6.1% in 2Q)
- **CAUTIOUS** about external environment; new government's policy implications
- 2019 Budget to **BOOST** private investment in tourism, manufacturing, IR 4.0 and e-commerce



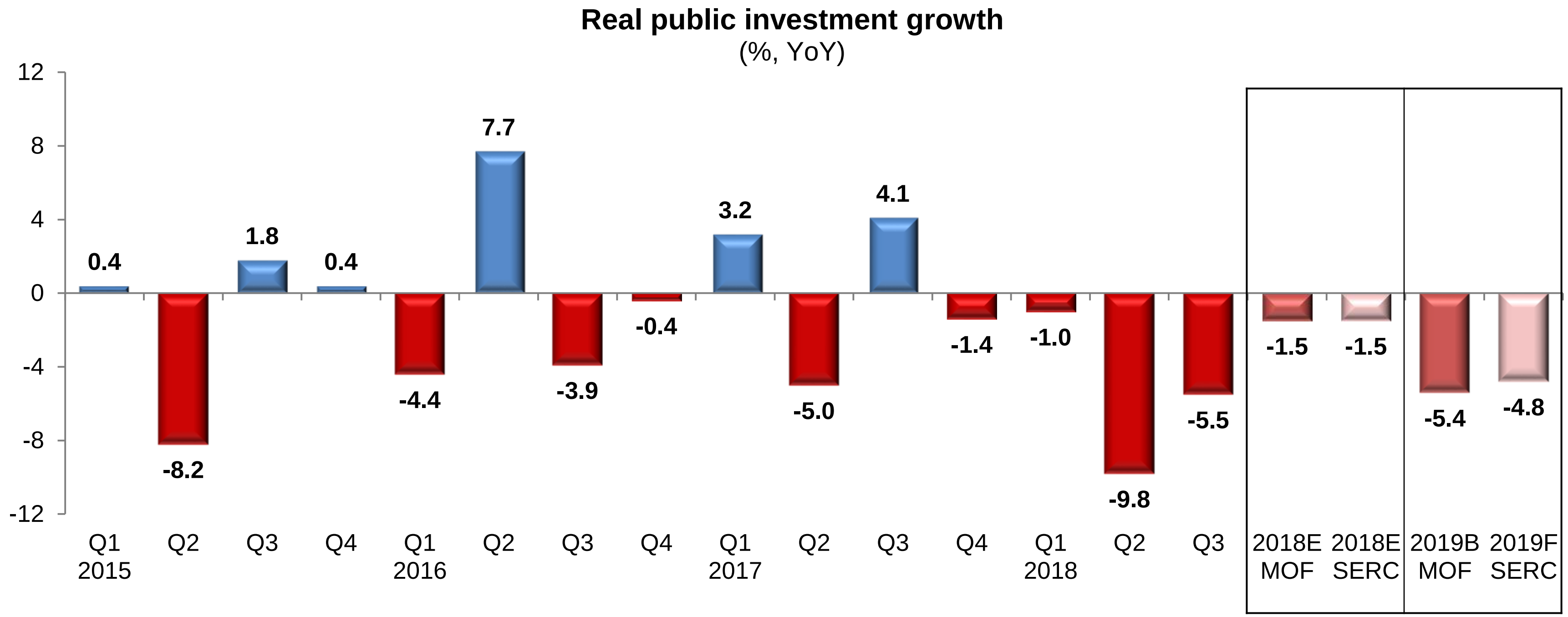




Source: DOSM; MIER

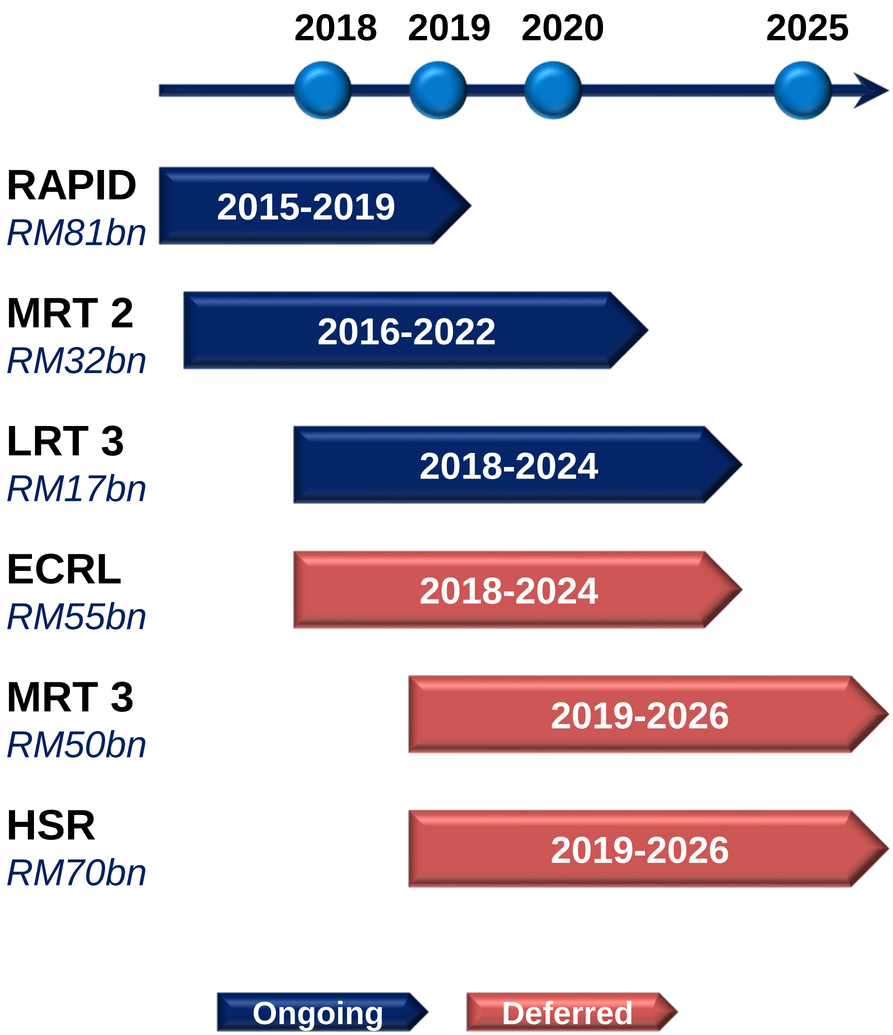
Public investment remains CLOUDED ahead

- **PUBLIC INVESTMENT GROWH CONTRACTED** for four straight quarters.
- Rationalisation of development expenditure means moderate public investment growth.
- Further consolidation of development expenditure in 2019.



Source: DOSM

DEFERRED OR CANCELLED mega projects: manageable impact



On-going projects help mitigating the impact on growth:

- In early stages of construction or have yet to commence
- Spreading effects (contained impact in single year) due to long period of development
- Depend on the localisation vs. imported of construction related materials and services
- Manageable impact on domestic employment

SERVICES sector is driving the economy

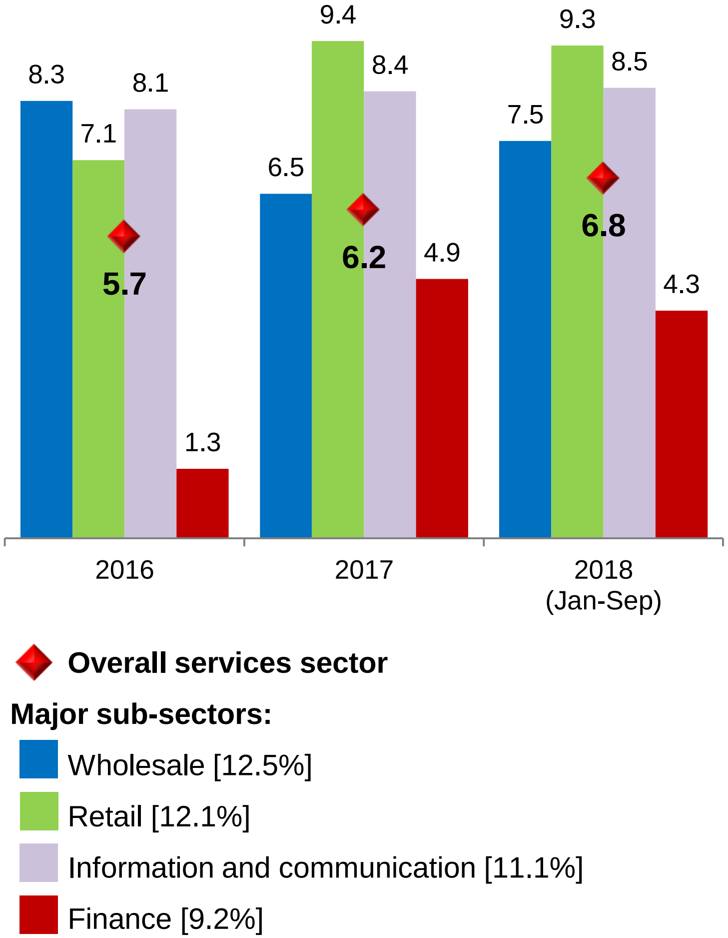
Services sector (2018E: 6.4%; 2019F: 5.8%)

% share of GDP in 2017: ***54.5%***

- Continued growth, albeit slower in some sub-sectors.
- Strong consumer spending will somewhat normalise following the 3-month "tax holiday" and the reintroduction of SST on 1 Sep.
- **Supporting factors**: Tourism activities; strong consumer sentiments; steady growth in income healthy labour market conditions and continued trade activities.
- **Pressing factors**: Potential review of fuel subsidy and cash-aid.

Services sub-sectors growth

(%, YoY)



Source: DOSM

[ ] indicates % of total services GDP in 2017

MANUFACTURING sector braces the escalation trade war

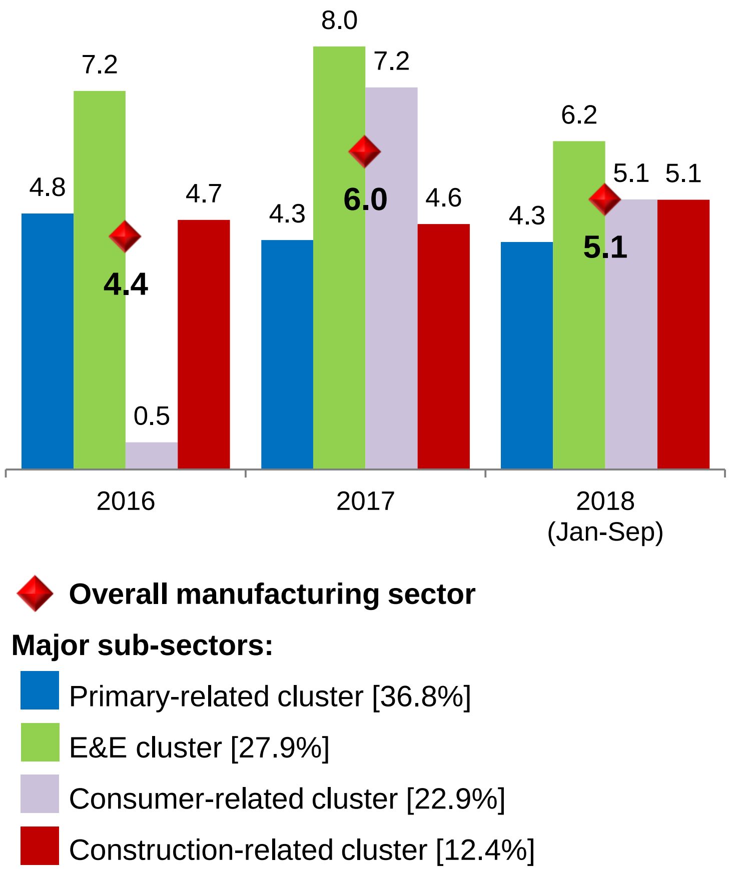
Manufacturing sector (2018E: 4.8%; 2019F: 4.5%)

% share of GDP in 2017: ***23.0%***

- Growth in electronics and electrical products and consumer-related clusters have moderated.
- Lack of short-term catalysts.
- **Supporting factors**: Diversion of orders arising from the deepening trade spats between the US and China, high global oil prices.
- **Pressing factors**: Slower semiconductor sales; supply chains disruption; slower domestic construction activities dampening demand of construction-related materials.

Manufacturing sub-sectors growth

(%, YoY)



Source: DOSM

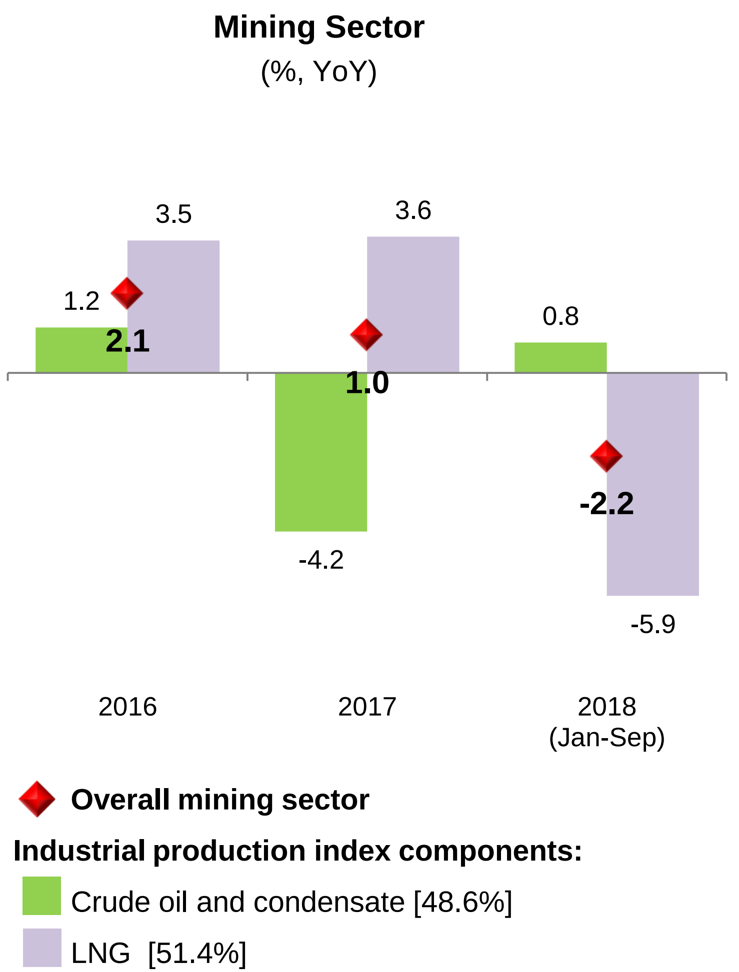
[ ] indicates % of total manufacturing GDP in 2017

MINING to rebound from a contraction in 2019

Mining sector (2018E: -1.0%; 2019F: 0.5%)

% share of GDP in 2017: ***8.4%***

- Crude oil prices surge on no formal agreement to increase production; supply disruptions due to sanction on Iran; cut in Venezuela's production.
- Gas leak incident in January 2018. PETRONAS is still waiting for approval from the authority to resume operations.
- **Supporting factors**: Resumption of LNG production.
- **Pressing factors**: Declining oil prices on strong US dollar, tighter liquidity conditions and concerns over slower global economic growth.



Source: BNM

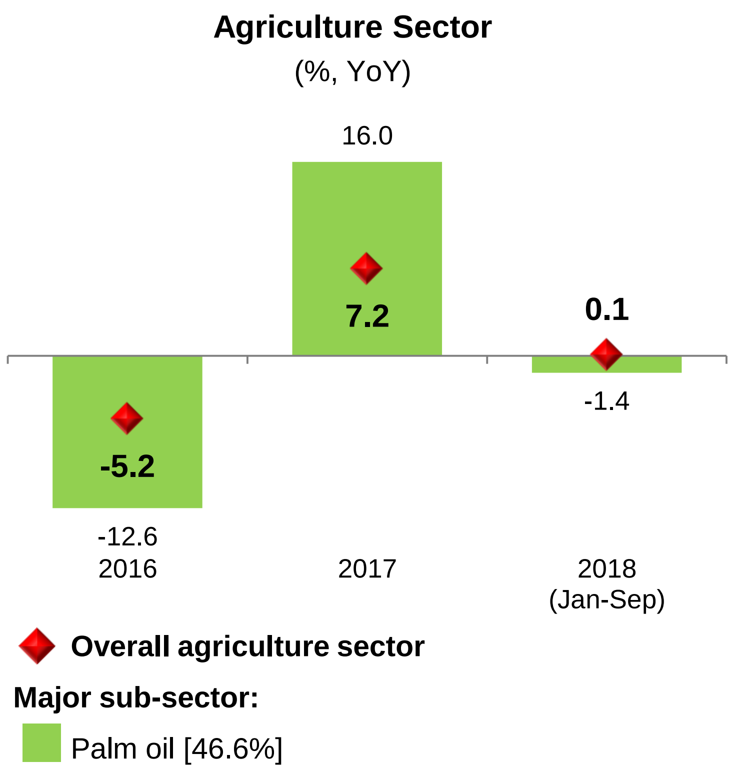
[ ] indicates weight of mining indices in 2015

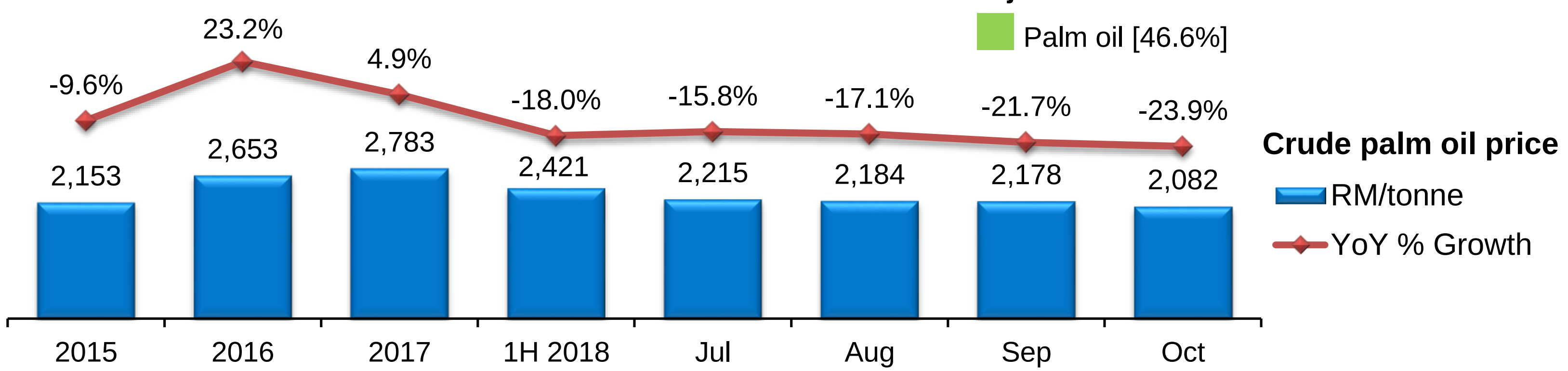
AGRICULTURE sector lack of short-term catalysts

Agriculture sector (2018F: -0.4%; 2019F: 2.0%)

% share of GDP in 2017: ***8.2%***

- High stocks level and declining CPO prices dampened the CPO outlook.
- **Supporting factors**: Zero export tax on crude palm oil in September 2018; weak ringgit
- **Pressing factors**: India announced a higher import tariffs at 44% on palm oil; EU had proposed to ban of using palm oil as biodiesel by 2021





Source: BNM

[ ] indicates % of total agriculture GDP in 2017

CONSTRUCTION momentum slows on the deferment of projects

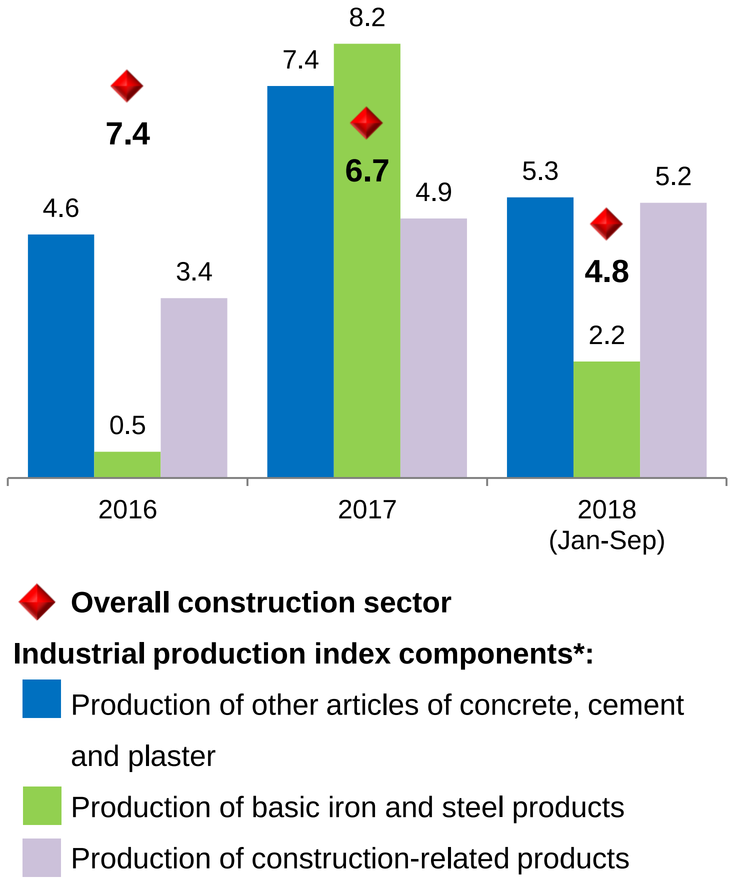
Construction sector (2018E: 4.5%; 2019F: 4.4%)

% share of GDP in 2017: ***4.6%***

- Post-GE14, several mega projects have been reviewed and some have been put on hold.
- **Supporting factors**: On-going projects (e.g. RAPID, MRT2 and LRT3) will partially offset the impact from deferred projects; some building materials (e.g. cement, sand and iron) were EXEMPTED under SST2.0.
- **Pressing factors**: The deferment of mega projects (e.g. ECRL, MRT3 and HSR) had been deferred; spillover effects to commercial and residential projects as would require longer time to build and re-marketing.

Construction Sector

(%, YoY)

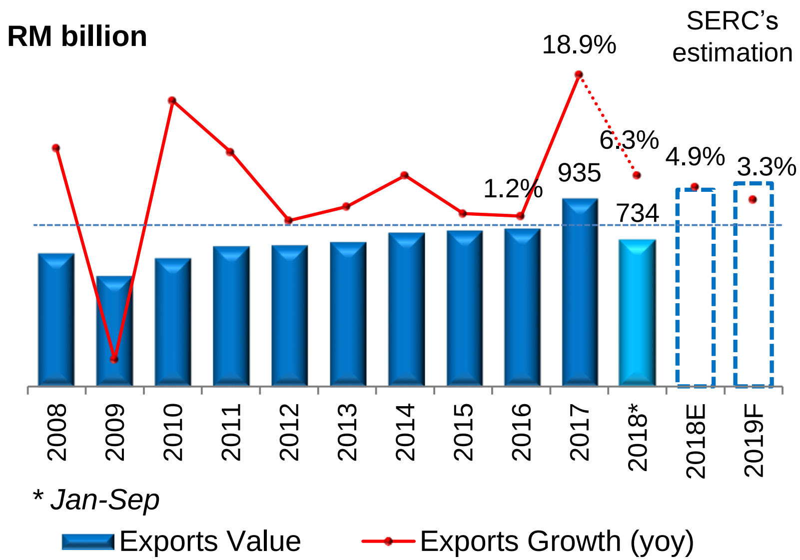


Source: BNM

** Jan-Aug 2018*

Exports in 2H18 and 2019 will be more CHALLENGING

Exports continue growing …



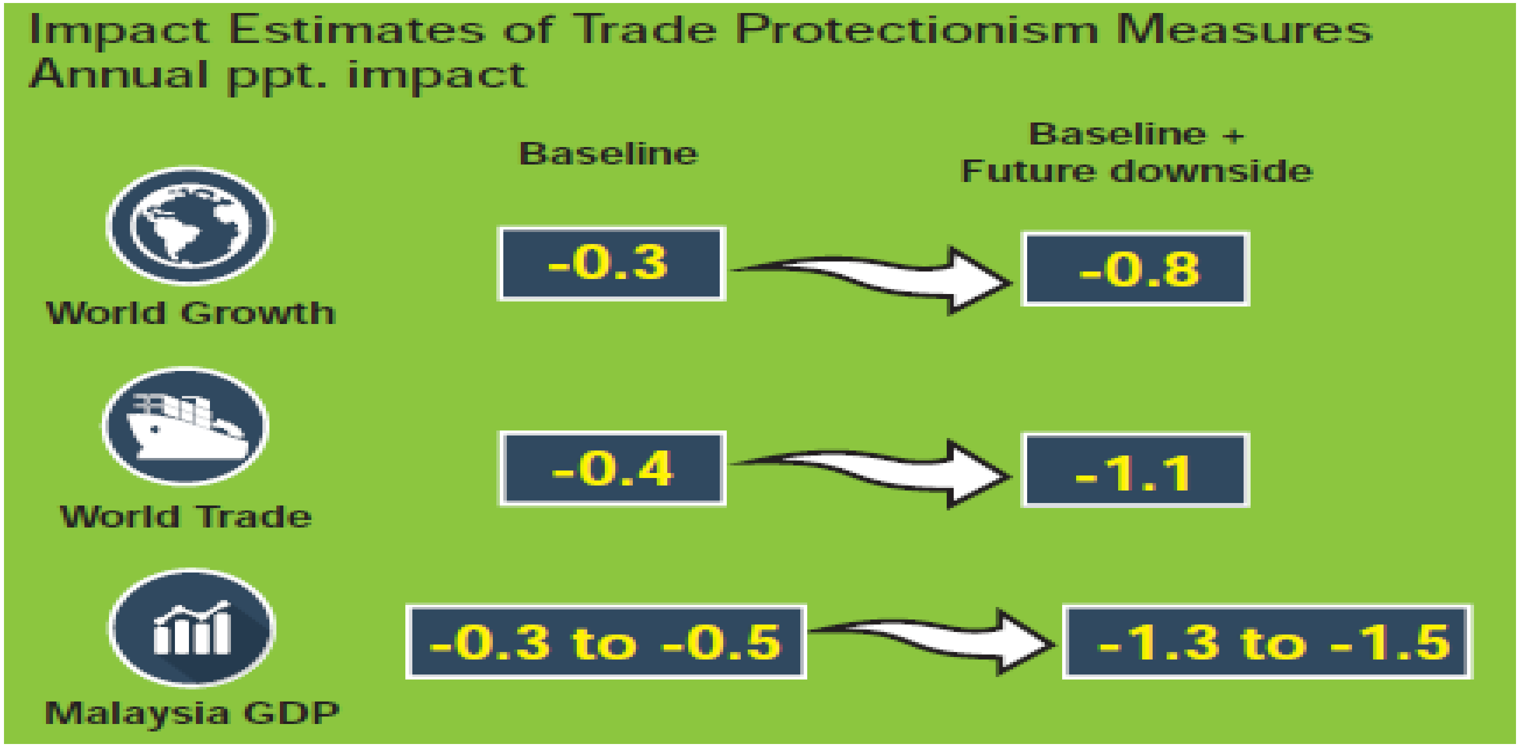
Broad-based expansion, except CPO & LNG

Major export products in 2018 (Jan-Sep) [% share]	**Value** *(RM billion)*	**Growth** *(% yoy)*
E&E products [38.0%]	278.5	10.7
Petroleum products [7.6%]	55.9	3.1
Chemical & chemical products [5.7%]	41.7	20.1
Manufactures of metal [4.6%]	33.5	22.1
Machinery, equipment & parts [4.2%]	30.6	0.5
Palm oil [4.0%]	29.2	-15.4
LNG [3.7%]	27.4	-10.6
Crude petroleum [3.6%]	26.7	31.9
Optical & scientific equipment [3.6%]	26.5	12.3

- **PRESSING FACTORS**: 1) Exceptionally high export levels averaging RM80.6 billion per month in 2H2017; 2) Moderate pace of global semiconductor sales (estimated 12-16% this year vs. 21.6% in 2017); 3) Softer CPO prices; and 4) Trade tensions between the US and its major trading partners.
- **Export growth estimates**: 4.9% in 2018 and 3.3% for 2019.

Source: DOSM

Further ESCALATION in trade tensions to have significant impact on GDP

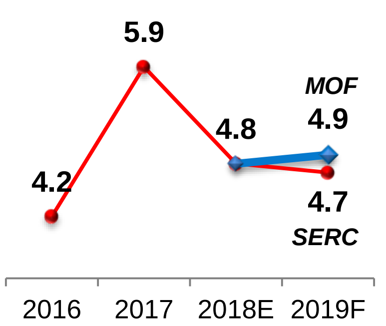


- Overall, the impact of bilateral trade tensions on Malaysia's export performance is largely dependent on the **substitutability of the affected products**, **manufacturing capacity constraints** and Malaysian **firms' value proposition.**

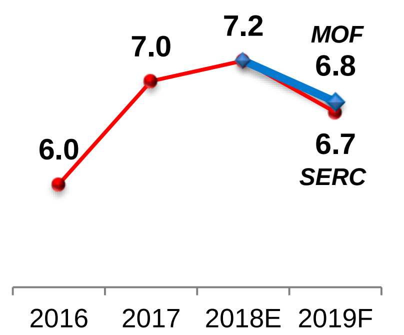
Source: Bank Negara Malaysia

Malaysia's key ECONOMIC INDICATORS

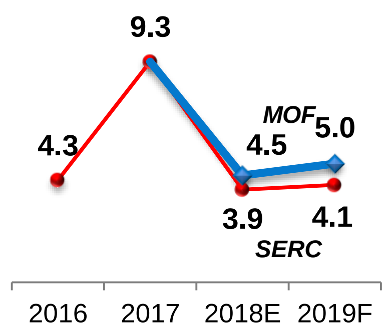
Real GDP Growth
(%)



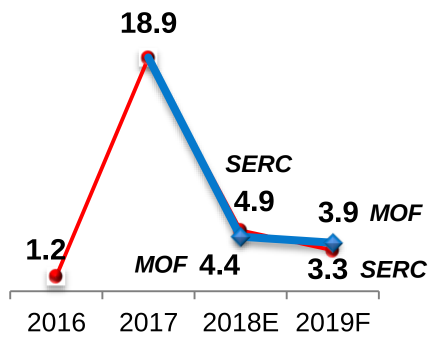
Private Consumption Growth
(%)



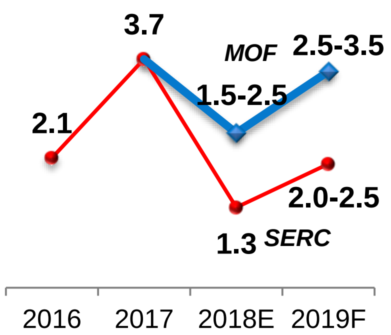
Private Investment Growth
(%)



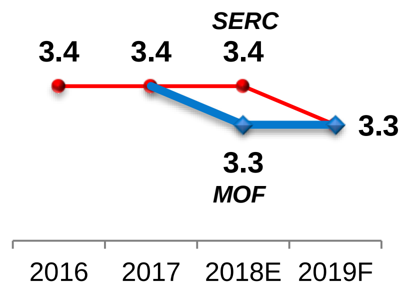
Gross Exports Growth
(%)



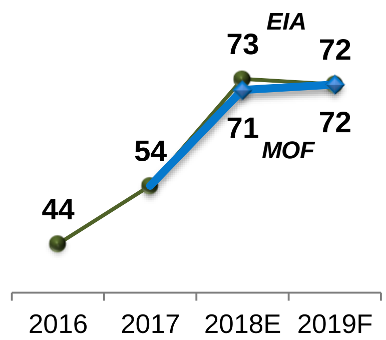
Inflation Rate
(%)



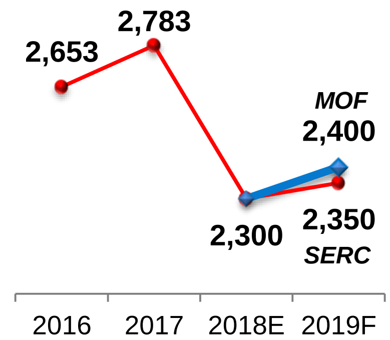
Unemployment Rate
(%)



Brent Crude Oil Prices
(US$/barrel)



Crude Palm Oil Prices
(RM/tonne)



Source: DOSM; MOF; EIA; MPOB; SERC

Sources of GDP growth: DEMAND and SUPPLY side

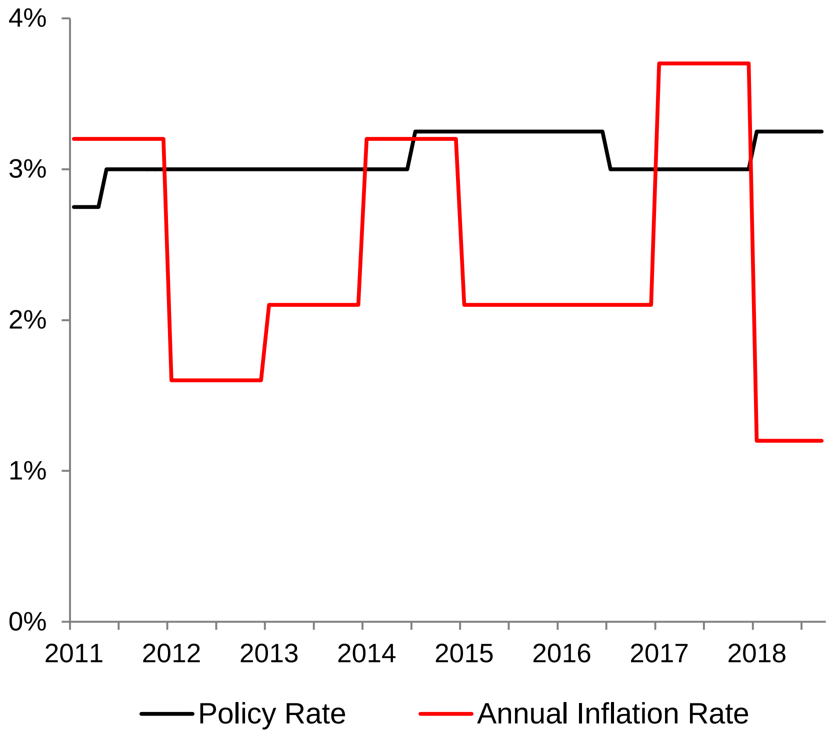
- Private sector expenditure will cushion the effects of lower public spending.
- All economic sectors are expected to register positive growth in 2019.

% growth, 2010=100	**2016**	**2017**	**2018 (Jan-Sep)**	**2018E (MOF)**	**2018E (SERC)**	**2019B (MOF)**	**2019F (SERC)**
GDP by demand component							
Private consumption (55.0%)	6.0	7.0	8.0	7.2	7.2	6.8	6.7
Private investment (17.3%)	4.3	9.3	4.5	4.5	3.9	5.0	4.1
Public consumption (12.5%)	0.9	5.4	3.0	1.0	1.8	1.8	0.7
Public investment (7.5%)	-0.5	0.1	-5.3	-1.5	-1.5	-5.4	-4.8
Exports of goods and services (70.9%)	1.3	9.4	1.6	2.0	2.5	1.6	2.0
Imports of goods and services (63.0%)	1.3	10.9	0.1	1.4	2.6	1.8	2.3
GDP by economic sector							
Agriculture (7.8%)	-5.2	7.2	-0.4	-0.2	-0.4	3.1	2.0
Mining & quarrying (8.0%)	2.1	1.0	-2.2	-0.6	-1.0	0.7	0.5
Manufacturing (23.0%)	4.4	6.0	5.1	4.9	4.8	4.7	4.5
Construction (4.5%)	7.4	6.7	4.8	4.5	4.5	4.7	4.4
Services (55.3%)	5.7	6.2	6.8	6.3	6.4	5.9	5.8
Overall GDP	**4.2**	**5.9**	**4.7**	**4.8**	**4.8**	**4.9**	**4.7**

Figure in parenthesis indicates % share to GDP in 2018E
Source: DOSM; MOF

Monetary policy should remain ACCOMMODATIVE (3.25% in 2019)

Overnight policy rate (OPR) vs. Annual inflation rate



- **HEADLINE INFLATION**: Underlying inflation remains low in 2018 due to transitory effect from 3-mth tax holiday and fuel subsidy. This transitory effect is expected to lapse in 2H19. Inflation outlook hinges on SST and the continued fuel subsidy. (2018E: 1.2%; 2019F: 2.0-2.5%).
- **GROWTH OUTLOOK**: The hurdle rate for BNM to consider cutting interest rate is when GDP growth slows to around 4.0% (GDP estimates 2018E: 4.8%; 2019F: 4.7%).
- **WILL THE WEAK RINGGIT OUTLOOK AND HIGHER US INTEREST RATES** constrain Bank Negara Malaysia's monetary policy?

Note: Average inflation rate for 2018 accounts from Jan-Sep.
Source: BNM; DOSM

The ringgit remains UNDER PRESSURE (end-2018: RM4.15-4.20; 1Q19: 4.05-4.10; 2Q: 4.05-4.10; 3Q: 3.95-4.00; 4Q: 3.95-4.00)

- **FACTORS WEIGH ON RINGGIT**: New political and policies transition; trade war; capital reversals; surging US Treasury yields; the expectation of further US interest rate hikes; contagion fear in emerging markets and a revived strength of the dollar.
- **COUNTERACT STRENGTH** to support the ringgit: Strong fundamentals, the clarity of policies, the fiscal and debt path as well as the affirmation of Malaysia's sovereign ratings.

Ringgit's movement against the USD

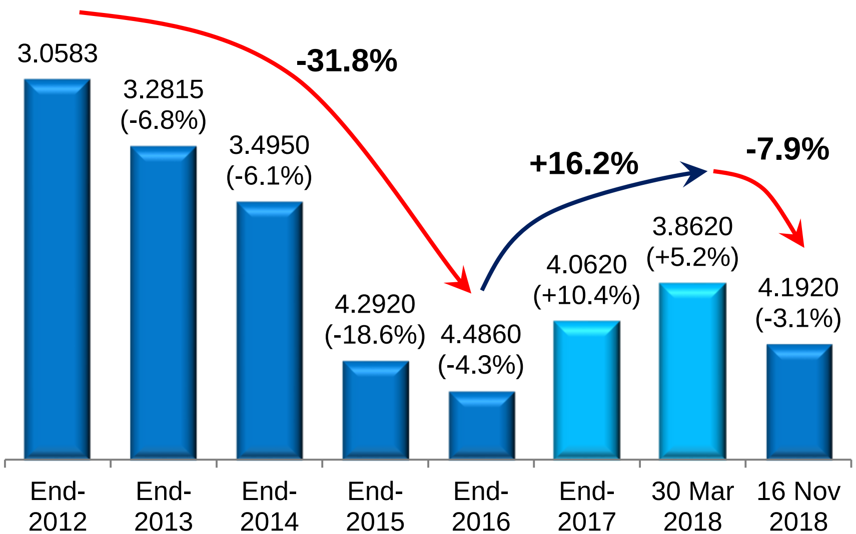
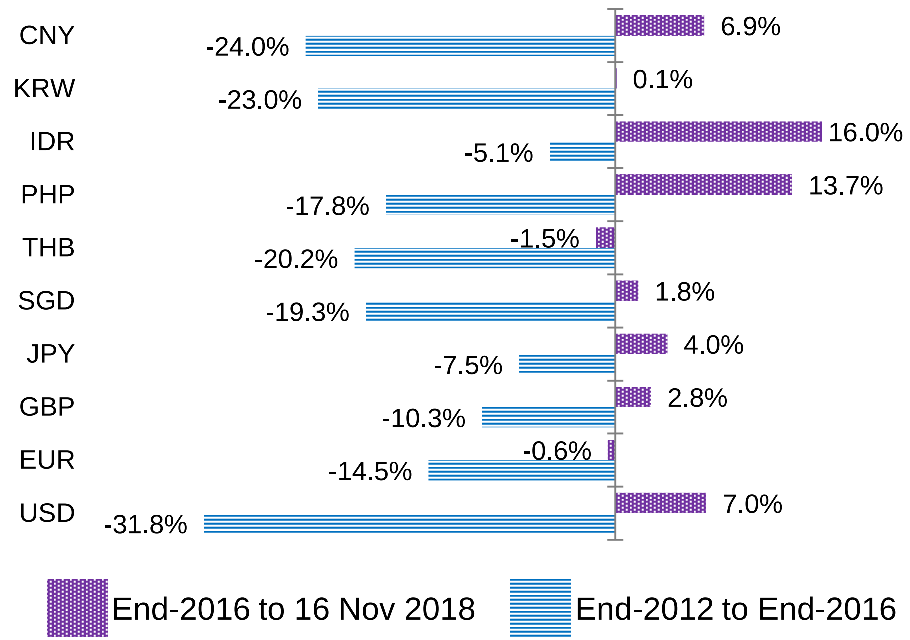


Figure in parenthesis denotes changes from end of previous year
Source: BNM (end-period; rates at 12:00)

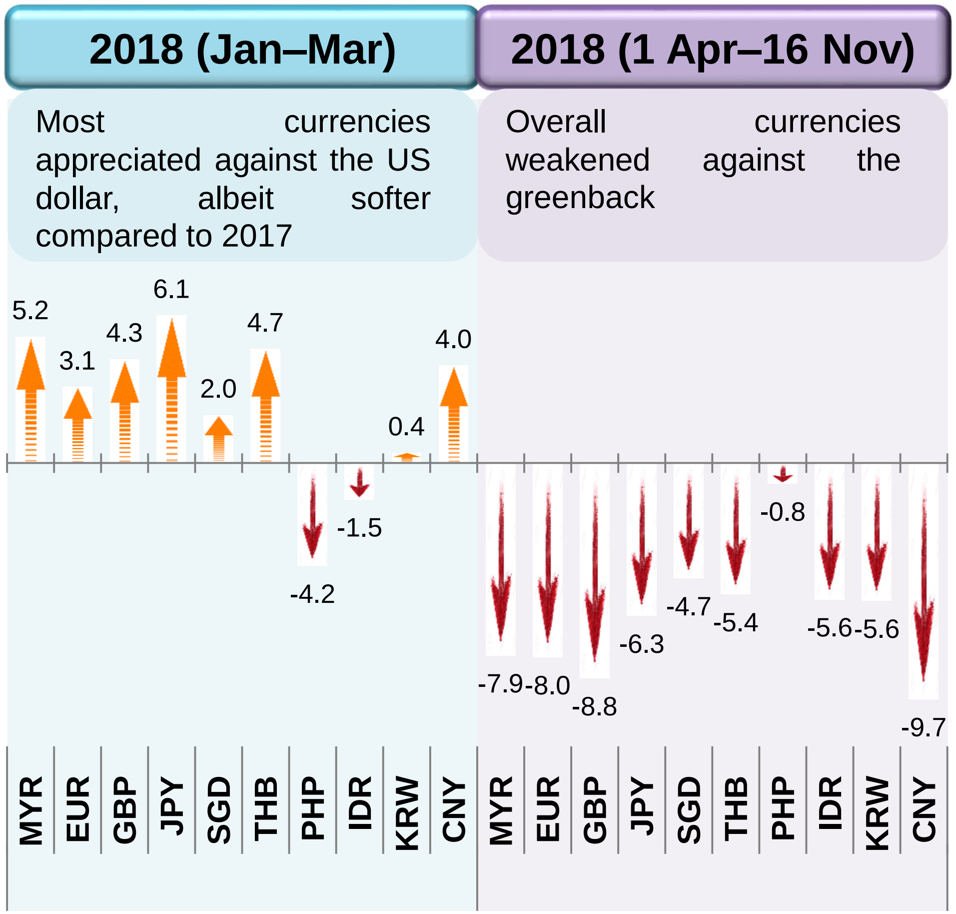
Ringgit's movement against regional currencies



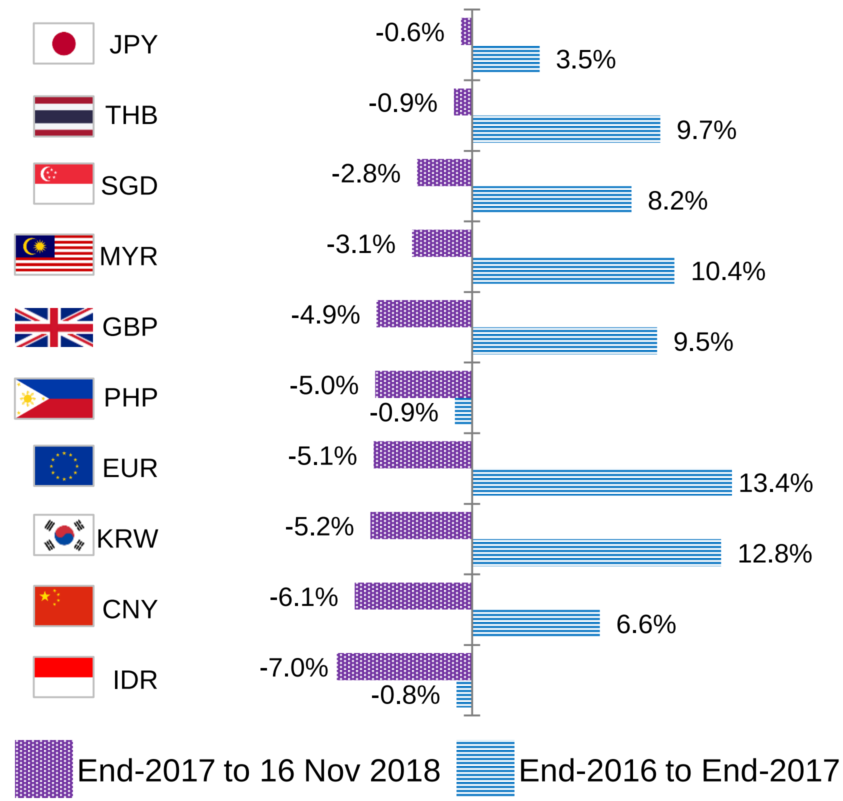
Regional currencies SUCCUMBED to strong US dollar

- The US dollar index strengthened by 7.1% against a basket of foreign currencies (measured in real effective exchange rate (REER)) in the first ten months of 2018.

Major and regional currencies vs. the US dollar* (%)



Year-to-date, most currencies have been depreciated against the greenback

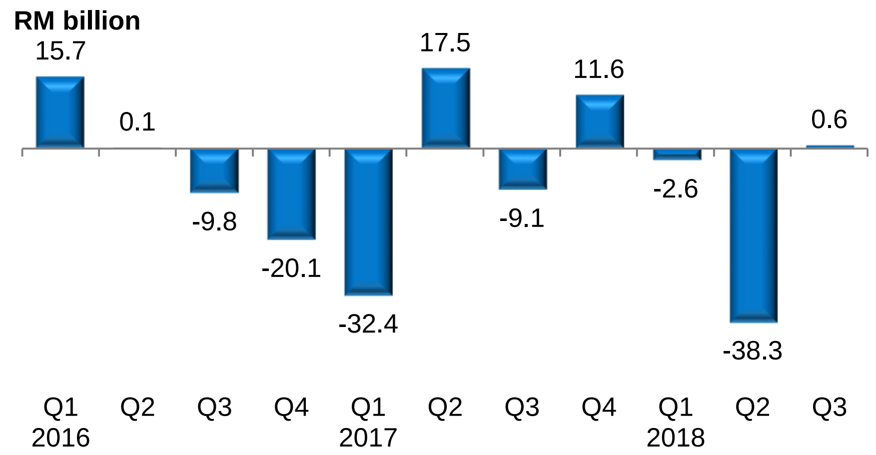


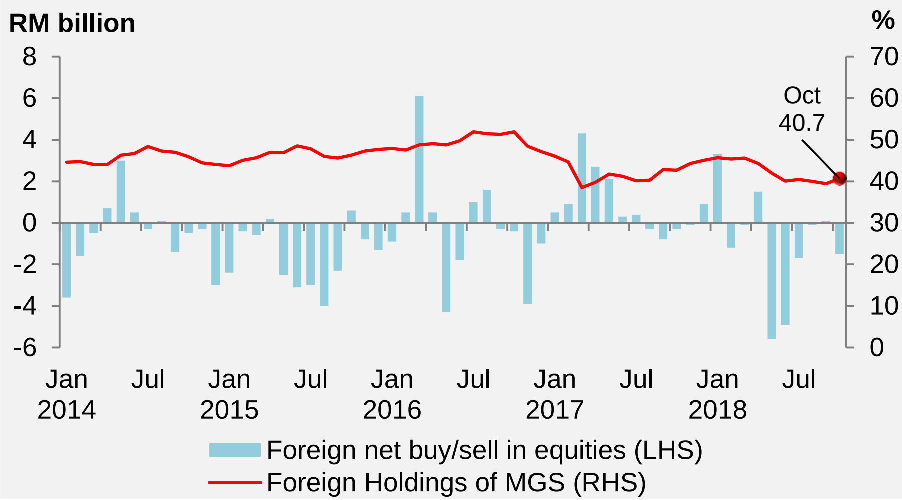
Source: BNM (end-period; rates at 12:00)   ** Calculation based on cross-rate*

Malaysia: OUTFLOWS in both debt and equity markets

- **EXTERNAL FACTORS**: Prospects of higher US interest rates; strong US dollar; uncertainties on global trade tensions; pressure on emerging markets triggered contagion risk
- **DOMESTIC FACTORS**: Post GE14 political and domestic policies transition
- In Apr-Jun, foreigners net sold RM24.3 billion of ringgit-denominated debt securities. Despite net buying occurred in July (+RM4.0 billion), it reverted to net selling in Aug-Sep (-RM5.4 billion)
- Post GE14's 32 consecutive days of net selling of equities by foreigners have moderated in July and August. Net foreign buying interests have returned marginally in September but retreated again in October and early November.

Net portfolio investment: Largest outflows since 3Q 2008

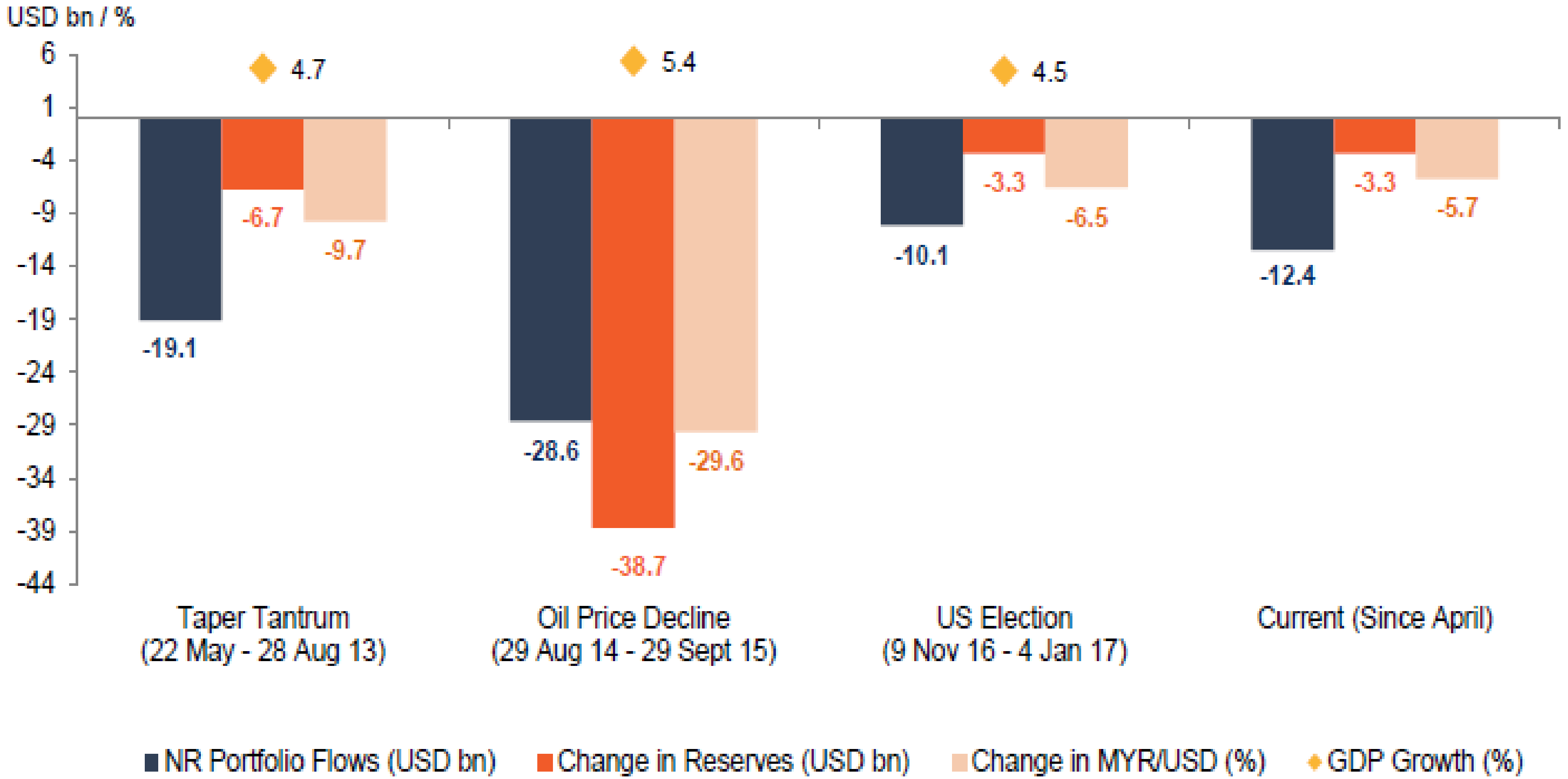




Source: BNM; Bursa Malaysia

Malaysia has experienced SIZEABLE capital reversals

NR Portfolio Flows, Reserves, Ringgit Performance and GDP Growth during Outflow Periods

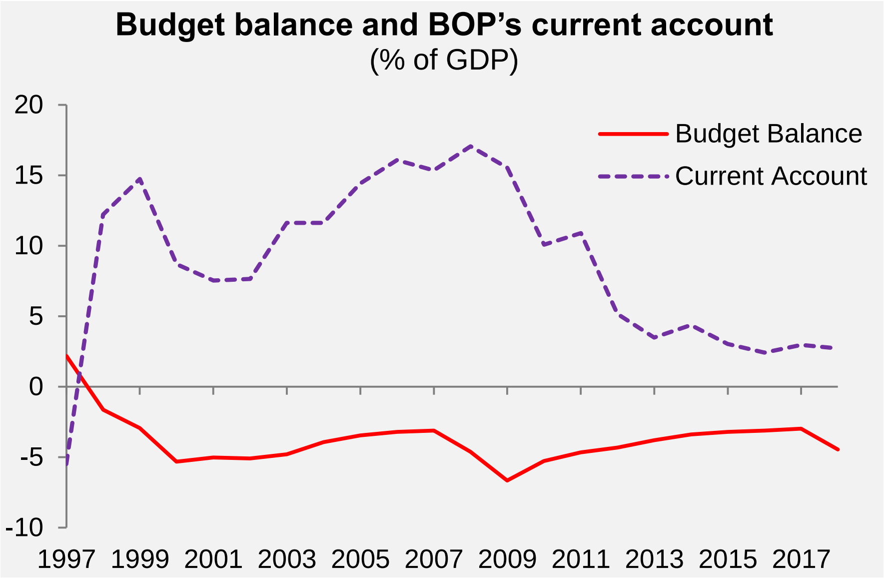


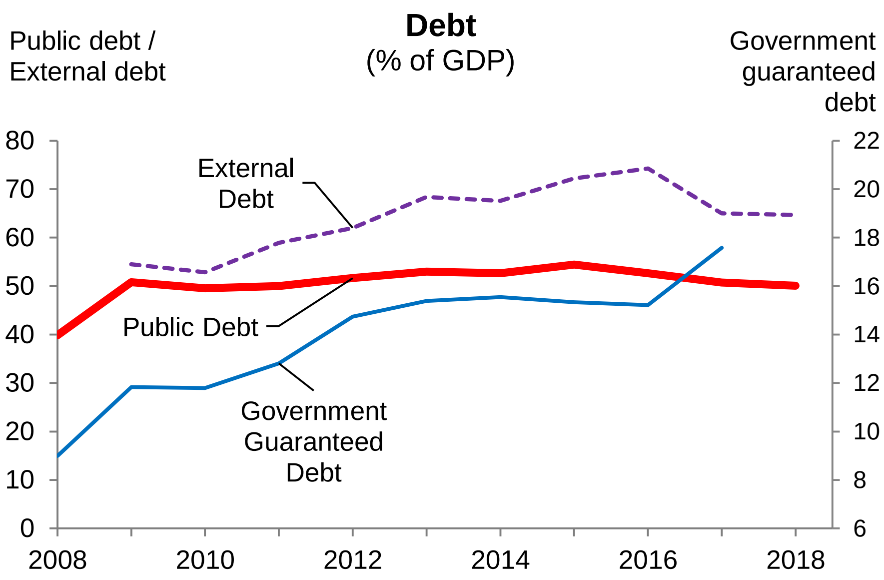
Note: Current data for reserves is at end-July 2018; MYR/USD as at 14 August 2018; NR portfolio flows as at 13 August 2018

Source: BNM

How Malaysia is 'DIFFERENT' from other emerging economies at risk?

- **NOT** at risk of **TWIN DEFICITS**.
- Manageable external debt (end-September: **RM947.9 billion or 66.2% of GDP**) in terms of **CURRENCY AND MATURITY PROFILES**.
  - ❑ Close to one-third of total external debt is denominated in **ringgit (30.6%)**
  - ❑ **69.4%** of total external debt in **foreign currencies** (End-2017: 51% in USD, 34.3% in ringgit, 2.2% in Japanese yen and others (12%))
  - ❑ **54%** is **medium- to long-term tenure** while the balance of **46%** is **short-term debt**
- **0.9x FOREIGN RESERVES TO SHORT-TERM EXTERNAL DEBT COVERAGE**. Banks and corporations held 75% of Malaysia's external assets totaling RM1.3 trillion at end-2Q18.





Source: BNM

Section 4

New Malaysia in Transition:

Reconstruction and Policies Adjustment

New Malaysia in TRANSITION: Policy PRIORITIES

POLITICAL AND ECONOMIC POLICIES TRANSITION – adjustment and transition costs; short-term pain for long-term gains if the Government wants to be **LEANER, MEANER AND BETTER**.

First, is to **RESTORE THE RULE OF LAW AND ACCELERATE INSTITUTIONAL REFORMS** for better Government and governance.

Second, **FISCAL RECONSTRUCTION** to maintain **FISCAL DISCIPLINE AND RESPONSIBLE BUDGET** as well as debt controls through reduced waste, leakage and weed out corruption.

Third, **RESTRUCTURE THE GOVERNMENT (PUBLIC SECTOR, including GLCS)** and **INSTITUTIONS** to restore public trust; to become a more effective and responsive enabler as well as good regulator.

A SMALLER, LESS INTRUSIVE ROLE FOR GOVERNMENT, MUCH MORE CONTAINED PUBLIC SERVICE AND A BIGGER ROLE FOR THE PUBLIC-PRIVATE PARTNERSHIPS UNDER MALAYSIA INCORPORATED

CRITICAL BUDGET ISSUES AND DECISIONS

FISCAL CHALLENGES

- **Tax revenue** under pressure under SST
- **Oil revenue & PETRONAS dividends** come to rescue **BUT** not sustainable
- **Non-tax revenue** to fetch more
- **Committed expenses** unlikely to cut more
- **Legacy obligations**

ECONOMIC CONDITIONS

- ❑ **External environment** still challenging
- ❑ **Global & trade** growth revised lower in 2019
  - ▪ **Global growth:** +3.7%
  - ▪ **Trade growth:** +4.0%
- ❑ **Domestic GDP growth** has slowed; **sentiments** softened

CASE FOR FISCAL RESET / RECONSTRUCTION

- ➢ **Drastic spending cut** would hurt economic growth
- ➢ **Prioritise & smart spending**
- ➢ **Revenue enhancement** measures to plug deficit
- ➢ **Push back** a near-balanced budget

Principles of RESTORING FISCAL HEALTH:

Fiscal transparency; Expenditure optimisation; Revenue enhancement

Competency

Accountability

Transparency

Public Finance Committee

- Strengthen fiscal administration
- “Zero-based” budgeting
- Fiscal Responsibility Act (by 2021)
- Government Procurement Act (by 2019)
- Debt Management Office (restructuring and rationalising government debt)

Tax Reform Committee

- Review the existing reliefs and incentives
- Look for sustainable revenue
- Ensure effective taxation system

The economy at a glance – PERFORMANCE and PROSPECTS

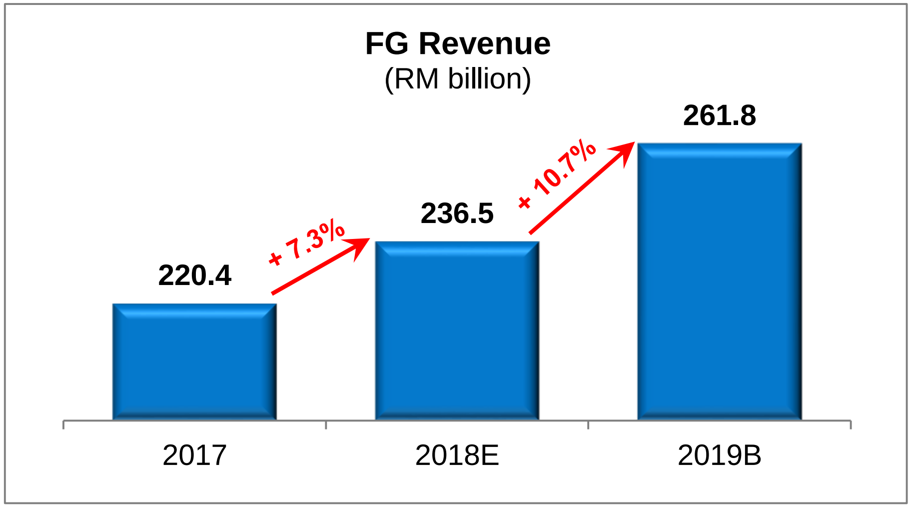
Key indicators	2017	2018E	2019B
Real GDP growth (%)^	5.9	4.8	4.9
Private consumption growth (%)^	7.0	7.2	6.8
Private investment growth (%)^	9.3	4.5	5.0
Income per capita (RM)	41,128	42,937	44,686
Unemployment (%)	3.4	3.3	3.3
Inflation (%)	3.7	1.5-2.5	2.5-3.5
Export Growth (%)	18.8	4.4	3.9
Current account balance			
RM million	40,275	38,591	33,995
% of GDP	3.0	2.7	2.2
Budget deficit			
RM million	40,321	53,327	52,080
% of GDP	3.0	3.7	3.4
Federal government debt			
RM million	686,837	725,241*	792,703
% of GDP	50.7	50.7	51.8
Contingent liabilities			
RM million	238,191	258,392*	332,078
% of GDP	17.6	18.1	21.7

Source: Ministry of Finance (MOF)
^ 2010=100
** As at end-June 2018*

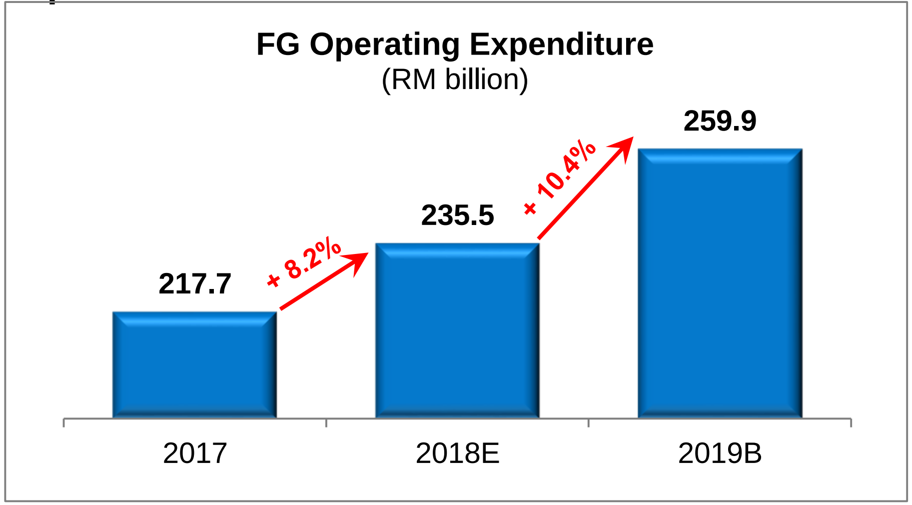
- **Sustaining economic growth**. The Malaysian economy is estimated to **grow by 4.8% in 2018 and 4.9% in 2019** respectively, supported by domestic demand and moderate external demand (SERC's estimates: 4.8% in 2018 and 4.7% in 2019 respectively).
- **Downside risks to growth** come from rising trade conflict, capital flows volatility, oil prices and geopolitical risks.
- **Domestic demand anchors overall growth**. **Consumer spending** growth still respectable (6.8% in 2019 vs. 7.2% in 2018) backed by stable employment and improved income. **Private investment** growth improved to 5.0% in 2019 from 4.5% in 2018. *SERC remains cautious amid external uncertainties and wary about domestic policy implications*.
- **Public sector's consolidation continues** as it rationalises its spending, focusing on cost savings and value for money projects and programs to support the economy.

2019 Budget analysis: REVENUE and EXPENDITURE

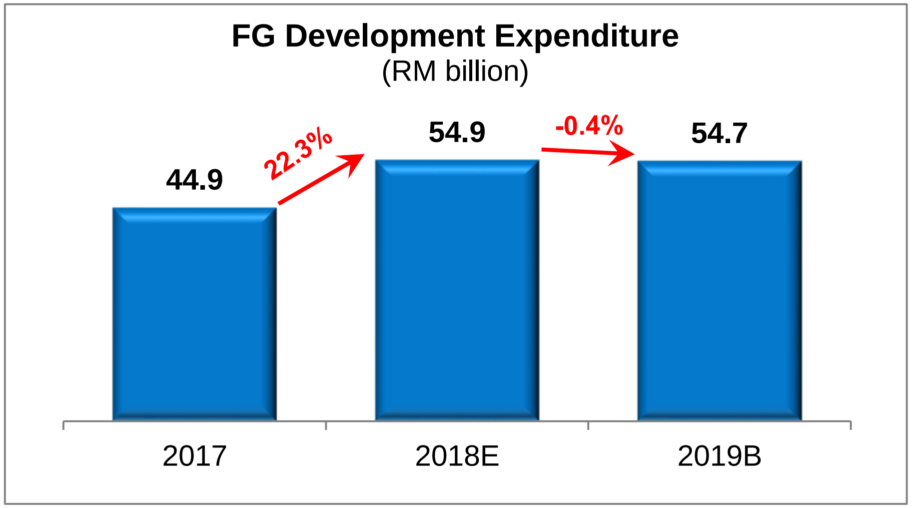
Revenue rises for three consecutive years



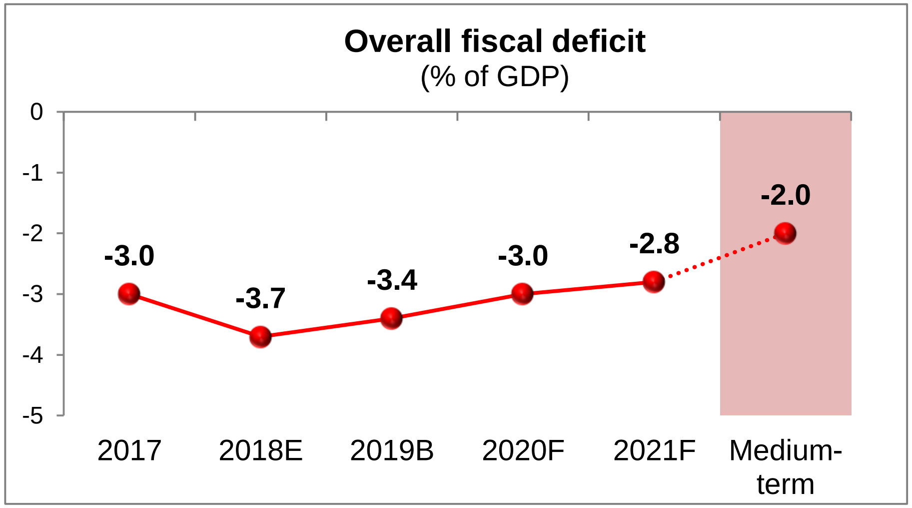
About 99.2% of revenue goes to operating expenditure



Development expenditure declined marginally to RM54.9bn in 2019



Fiscal deficit to narrow gradually



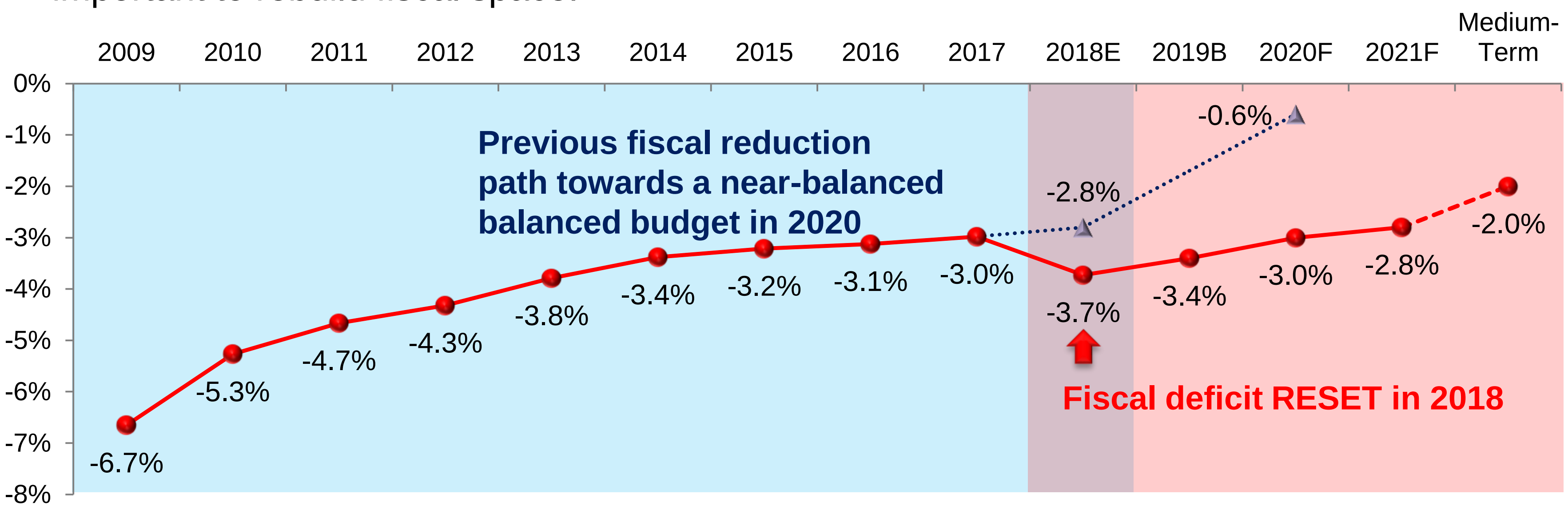
Source: MOF

Fiscal deficit RESET on a clean slate

- **Overall fiscal deficit** is reset higher to **-3.7 % of GDP in 2018** (from -2.8% previously) due to:
  a) Shortfall in revenue
  b) The GST and income tax refunds (RM3.9bn or 0.3% of GDP in 2018 and RM37.0bn or 2.4% of GDP in 2019); and
  c) Restating of off-budget items and unbudgeted expenses as well as reclassification of capital expenditure in operating expenditure to development expenditure.

- Fiscal deficit to GDP ratio will come down **to -3.4% in 2019, narrowing further to -3.0% in 2020** and **-2.8% in 2021.**

- **Restoring fiscal health** remains a priority. A **timeline returning the budget to balance** is important to rebuild fiscal space.



Source: BNM, MOF

Will Malaysia's sovereign rating at RISK?

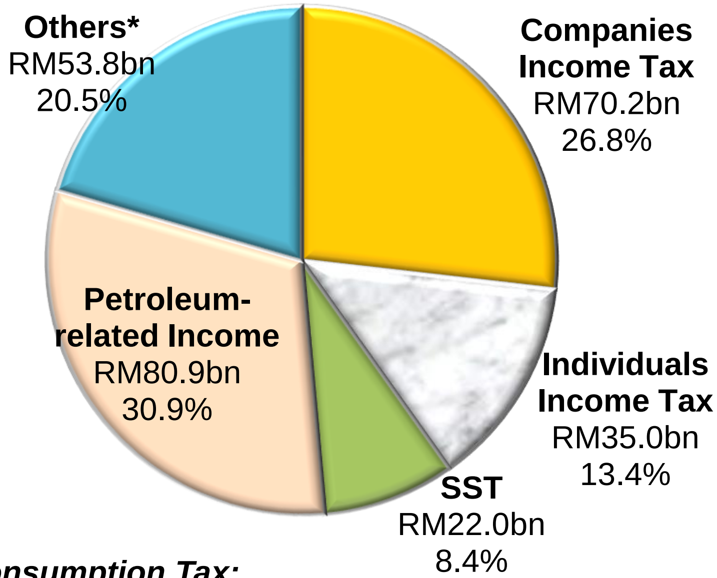
- **Fitch Ratings** – *Malaysia's* ***public debt is high*** *"relative to rating peers", and* ***a further increase in debt*** *over the medium-term could have a rating impact.*
- **S&P Global Ratings** – *A heavier reliance on* ***commodity-based revenues*** *presents an additional risk to Malaysia's fiscal accounts*.
- **Moody's** – *Wider deficits and a heightened reliance on* ***volatile oil-related revenues****.*
- **Impact on Malaysia's sovereign rating***: a low likelihood of a rating downgrade. A downgrade could be triggered by any one of a series of factors: slowing economic growth prospects, deteriorating external debt, political instability or lack of fiscal reforms.*

	Date of change	Grade			Date of change	Outlook		
		From	To			From	To	
Fitch Ratings	8 November 2004	BBB+	A-	↑	30 June 2015	Negative	Stable	↑
S&P Global Ratings	7 October 2003	BBB+	A-	↑	15 May 2008	Positive	Stable	↓
Moody's	16 December 2004	Baa1	A3	↑	11 January 2016	Positive	Stable	↓

Source: Fitch; S&P; Moody's; Trading Economics

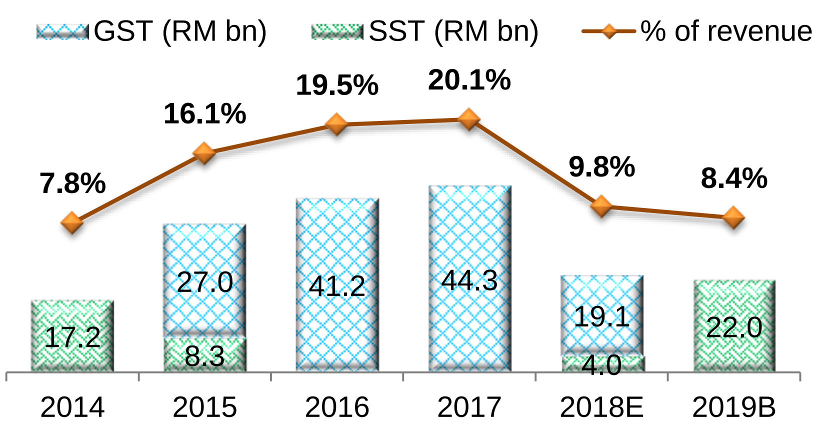
DISTRIBUTION in revenue

2019B: Where is the money coming from?

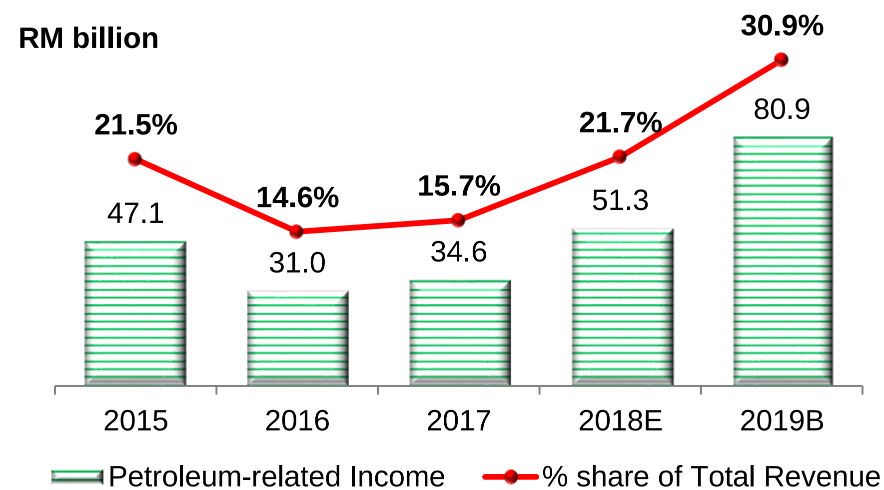


- **SST revenue** budgeted at RM22.0bn, accounted for 8.4% of total revenue (2018: RM4.0bn).
- Company income tax (-0.5% to RM70.2bn); Individual income tax (+0.4% to RM35.0bn)
- **Petroleum-related income** increased by 56.7% to RM80.9bn (of which **RM30.0bn is PETRONAS's special dividend**).
- **Oil price assumption**: US$71/bbl in 2018 and US$72/bbl in 2019.

Consumption Tax:



Petroleum-related Revenue:

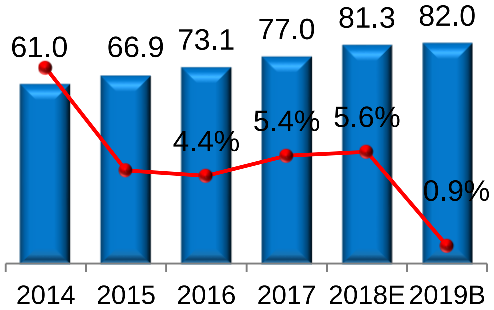


** Includes non-tax revenue, excise duty, stamp duty, etc.*
Source: MOF

Operating expenditure analysis calls for FURTHER RESTRAINT

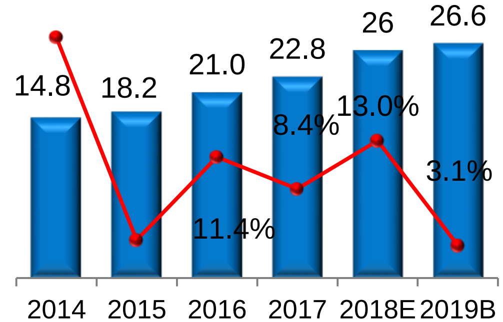
31.6% of total OE

Emoluments
(RM billion)



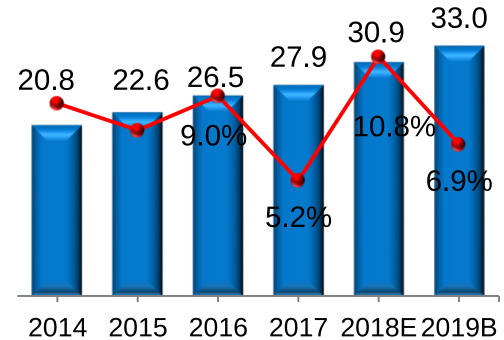
10.2% of total OE

Retirement charges
(RM billion)

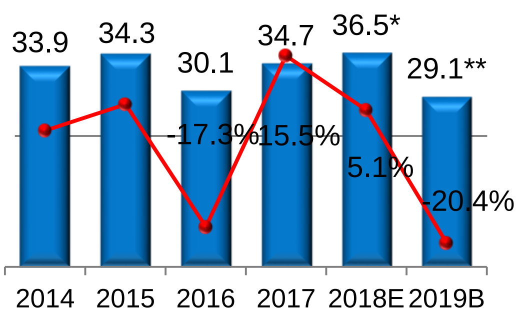


12.7% of total OE

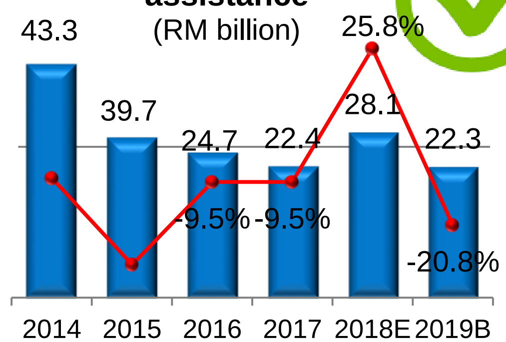
Debt service charges
(RM billion)



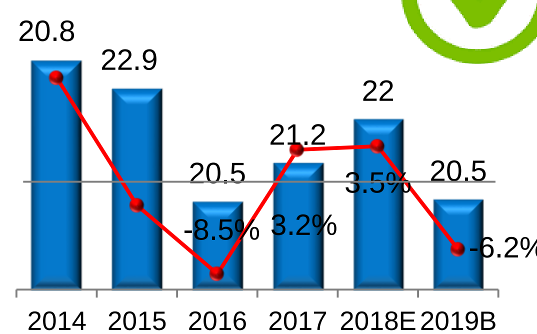
Supplies and services
(RM billion)



Subsidies and social assistance
(RM billion)



Grants and transfers[1]
(RM billion)



*Note: Line chart indicates changes of operating expenditure; * Higher due to RM3.8bn for hospital cleaning services, school security, asset and system maintenance. ** Reclassification of items related to capital investment from OE to DE; reprioritise of projects under zero-based budgeting; [1] Includes grants and transfers to state governments and grants to statutory bodies; the line indicated as 0%*
Source: MOF

Development expenditure: SECTORAL ALLOCATION

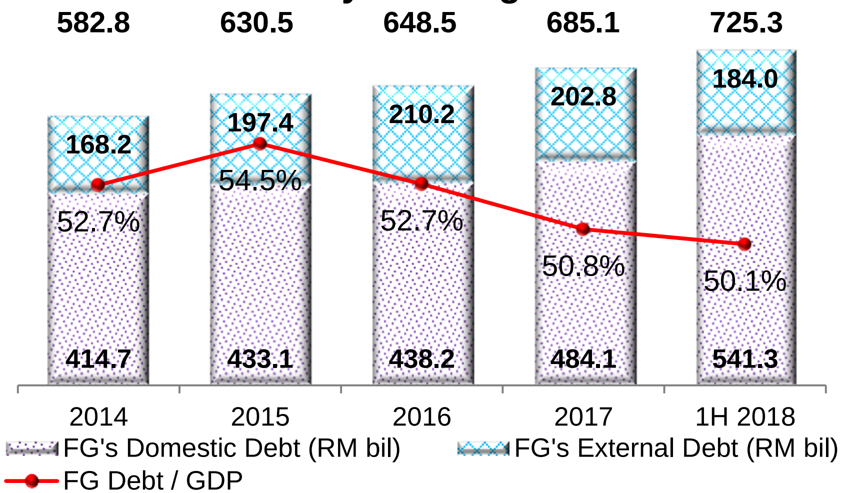
By Sector	2017	2018E	2019B	2017	2018E	2019B	2017	2018E	2019B
	RM million			% YoY			% Share		
Economic	**24,186**	**33,025**	**29,235**	**-3.7**	**36.5**	**-11.5**	**53.9**	**60.2**	**53.4**
Agriculture and rural development	2,219	2,191	2,278	-23.5	-1.2	3.9	4.9	4.0	4.2
Energy and public utilities	2,475	3,379	4,589	-15.4	36.5	35.8	5.5	6.2	8.4
Trade and industry	3,800	6,686	5,721	-21.5	75.9	-14.4	8.5	12.2	10.5
Transport	10,429	15,501	13,388	33.2	48.6	-13.6	23.2	28.2	24.5
Environment	2,061	1,725	2,134	-12.1	-16.3	23.7	4.6	3.1	3.9
Others	3,202	3,543	1,125	-25.0	10.6	-68.2	7.1	6.5	2.1
Social	**12,425**	**14,507**	**15,183**	**19.1**	**16.8**	**4.7**	**27.7**	**26.4**	**27.8**
Education and Training	6,306	7,307	8,287	69.2	15.9	13.4	14.0	13.3	15.2
Health	1,470	1,897	2,257	-1.7	29.1	19.0	3.3	3.5	4.1
Housing	785	1,144	1,852	-64.9	45.8	44.4	1.7	2.1	3.0
Others	3,864	4,159	2,987	30.1	7.6	-28.1	8.7	7.5	5.5
Security	**5,334**	**5,338**	**7,082**	**10.4**	**0.1**	**32.7**	**11.9**	**9.7**	**12.9**
Defence	4,315	3,649	3,737	9.4	-15.4	2.4	9.6	6.6	6.8
Internal Security	1,019	1,689	3,345	14.9	65.8	98.0	2.3	3.1	6.1
General Administration	**2,939**	**2,030**	**3,200**	**81.4**	**-30.9**	**57.6**	**6.5**	**3.7**	**5.9**
Total	**44,884**	**54,900**	**54,700**	**6.9**	**22.3**	**-0.4**	**100.0**	**100.0**	**100.0**

Source: MOF

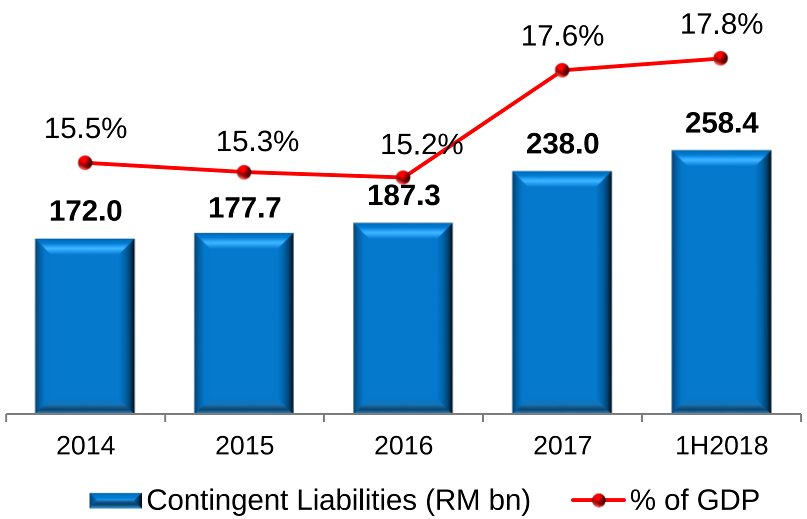
FG's total DEBT AND LIABILITIES (2018: RM1.068 trn or 74.6% of GDP; 2019: RM1.125 trn or 73.5% of GDP)

- **Federal government's debt stood** at **RM725.3bn at end-June 2018**, a rise of 5.9% from RM685.1bn at end-2017. **Debt to GDP ratio stood at 50.1% at end-June 2018** (2017: 50.8% of GDP).
- **Federal government's contingent liabilities** (government guarantees) stood at **RM258.4bn or 17.8% of GDP at end-June 2018** (2017: RM**238.2**bn; **17.6**% of GDP).
- The **Federal Government debt, contingent liabilities and commitment made under public-private partnership (PPP) projects** stood at **RM1.057 trillion** or **80.3% to GDP as at end-2017**.

FG debt to GDP ratio improves due to the transfer of Treasury Housing Loan



Government guarantees debt on the rise



Source: BNM; MOF

2019 Budget: Who are the LOSERS? WINNERS?

Digital & Industry 4.0

B40

Healthcare

Beverages industry

Gaming

SMEs

First-time home buyer and developers

Rubber smallholders

Property investors & developers

Tourism

Promote GROWTH and GLOBAL COMPETITIVENESS

- Business transaction costs and cost of doing business (direct and indirect) must be kept **REASONABLE AND COMPETITIVE** as well as at ease through removing the constraints in hard and soft infrastructure, including the binding regulatory and layering as well as unnecessary compliance costs.

- A critical anchor of successful industrial development policy is to focus on growing the industries and sectors that conform to our **LATENT COMPARATIVE ADVANTAGES** to counteract dynamic competitive and comparative advantages of our competitors.

- The **IDENTIFIED SECTORS** include the downstream resource-based **MANUFACTURING ACTIVITIES, SERVICE SECTOR, E-COMMERCE, DIGITALIZED BUSINESS AND THE ENVIRONMENTAL SECTOR**.

- New service industries that have emerged and are growing rapidly are in the areas of Fintech-finance, ICT, logistics, e-commerce, sharing economy, healthcare, higher education, tourism, hospitality and the Halal market not just in food, but in pharmaceuticals, cosmetics, and many more.

- **EXPORTS CAPACITY** in terms of products' differentiation and markets diversification should be further enhanced.

社会经济研究中心

SOCIO-ECONOMIC RESEARCH CENTRE

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谢 谢
THANK YOU

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