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Cover Story: Shared burden

By Cindy Yeap / The Edge Malaysia | February 18, 2016 : 4:00 PM MYT

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Demonstrating Malaysia's fiscal flexibility, Prime Minister Datuk Seri Najib Razak last Thursday announced that the country will stick to its 3.1% fiscal consolidation target for 2016, maintain its 55% government debt-to-GDP ceiling and still meet the minimum 4% GDP growth announced when oil prices were at US$48 a barrel.

This is an improvement on the Budget 2015 revision in January last year when GDP growth was revised downwards from between 5% and 6% to between 4.5% and 5.5% and the fiscal deficit target had to be revised from 3% to 3.2% of GDP. At the time, there was a steeper decline in oil prices and the budget assumption had to be almost halved from US$100 to US$55 a barrel and the revenue shortfall was RM13.8 billion when the budget was recalibrated.

This time around, Malaysia expects a revenue loss of RM7 billion to RM9 billion, largely from oil-related sources, as the oil price assumption for the revised Budget 2016 has been nudged to between US$30 and US$35 a barrel.

What's more, in a subsequent industry forum in Putrajaya, Treasury secretary-general Tan Sri Dr Mohd Irwan Serigar Abdullah said Malaysia will not need to review Budget 2016 again even if oil prices fell to US$20 to US$25 levels, citing flexibility from potential asset sales, for example income from a telecommunications spectrum tender, which had not been included in the revenue assumption.

He also said Malaysia will not be alone in needing to rethink its options should the oil bear pundits prove to be right (Goldman Sachs, Standard Chartered, Morgan Stanley and RBS are among those that have cut their oil price outlook to as low as US$10 a barrel on oversupply concerns) but noted that the US$30 to US$35 oil price range was within prevailing consensus.

Are the projections realistic?

"The government had to stick to its guns on the budget deficit and government debt ceiling, considering the apparent sovereign credit rating review by Standard & Poor's next month and the constraints of government debt-to-GDP of 54.3% at end-2015, which is almost there against the self-imposed debt ceiling," says Suhaimi Ilias, Maybank Investment Bank's group chief economist.

"But we should not underestimate or ignore potential upside surprises in non-oil revenue in view of the yet-to-be-quantified measures, like auctioning telecoms spectrum and selling land to better monetise government assets, tax audit and amnesty and curbing leakages on tax-free islands.

“Furthermore, the consumer spending stimulus measures (for example, EPF cuts, special income tax relief) can lift GST revenue. Presumably, the MoF (Ministry of Finance) has considered this in stating that even if crude oil price goes to US$25 per barrel, the budget deficit target of 3.1% is intact.”

Some experts still need convincing with the primary complaint being a lack of details.

“Maintaining fiscal discipline is good but we are not entirely convinced that the fiscal deficit targets can be met, giver the lack of details on specific cuts, the size of potential additional revenue [such as from a 900/1800 MHz spectrum tender] and the slowing economy,” says Chua Hak Bin, Bank of America Merrill Lynch’s (BaML) Asean economist.

“The sense is spending cuts 70% while 30% new tax revenue [are] to make up for the loss of revenue [from lower oil prices]. It remains to be seen if slower economic growth will have a large negative impact on non-oil revenue, particularly corporate earnings and taxes.”

Credit Suisse economist Michael Wan writes in a Jan 28 note: “The spending cuts to achieve fiscal deficit targets are big on headlines but short on details. In particular, the government did not go into the specifics of how it would cut operational and development spending by a sizeable RM8 billion, apart from saying that it will focus on more important projects and reduce grants to GLCs.”

He adds, though, that Malaysia’s revenue estimates “seem quite conservative and don’t include wild assumptions from some of the revenue raising measures”.

BaML's Chua, who maintained his fiscal deficit projection at 3.5% last Thursday, hopes to see "greater clarity on where [the cuts are] coming from" in the coming weeks. "It will be quite a feat if Malaysia can maintain its fiscal deficit target at 3.1% this year despite the external headwinds," he says.

Forecast

	BUDGET 2016	REVISED BUDGET
OIL PRICE ASSUMPTION	US$48	US$30–35
GDP GROWTH	4–5%	4–4.5%
FISCAL DEFICIT	3.1%	3.1%
INFLATION	2.1%	2.5–3.5%

Chua is concerned about Malaysia's rising quasi-public debt of about 70% of GDP, widening public sector deficit and growing leverage of non-financial public corporations that are undertaking many infrastructure projects.

Maybank IB's Suhaimi concurs but is more sanguine: "Quasi-public debt concerns will continue as major infrastructure projects like the MRT and KL-Singapore High-Speed Rail are being undertaken by MoF-owned SPVs (special purpose vehicles) but the main and ultimate concern was 1Malaysia Development Bhd's debt, which is now being addressed without recourse to the government."

Whatever one's stand on the latter and the extent to which Malaysia can expand its revenue sources, Citi Research economists Kit Wei Zheng and Siddharth Mathur note in a Jan 28 report that "few details on petroleum revenue assumptions were released". They add that they "would not be surprised" if it were more conservative than their projection of a RM5 billion drop to RM24.4 billion, assuming an oil price of US$30.

It is worth noting that Petroliam Nasional Bhd's promise of a RM16 billion dividend for 2016 is unchanged and oil related-revenue was already projected to fall to RM31.7 billion or 14.1% of total government revenue this year when oil was at US$48 a barrel. Every US$1 fall in oil price was estimated to translate into a revenue loss of RM300 million for the government.

Under the reworked Budget 2016, total government revenue has been revised lower by between RM7.8 billion and RM9.4 billion to between RM216.3 billion and RM217.9 billion from RM225.7 billion, according to slides shown at the forum. The budget deficit remains largely unchanged at between RM38.5 billion and

RM38.7 billion compared with the RM38.8 billion that was projected when oil price was at US$48.

Operating expenditure is supposed to fall between RM4 billion and RM4.5 billion to between RM210.7 billion and RM211.2 billion as the government cuts back on supplies and services (estimated at RM36.3 billion, according to the Economic Report 2015/16 released in October last year) and continues to rationalise grants to statutory bodies (RM28.6 billion, according to the same Economic Report).

Development expenditure is to fall by between RM4 billion and RM5 billion to between RM45 billion and RM46 billion as projects with low multiplier effects, such as land purchases, are pushed back.

All in, Citi Research's economists say they are "neutral to modestly positive at face value" but "await further details".

"Overall, today's headlines were well within expectations and taken at face value would signal resilience of the fiscal position to oil price declines. While details are lacking for a comprehensive assessment, RM7 billion to RM9 billion of revenue drop is more conservative than anticipated while the growth supportive and revenue-enhancing measures have historically proved effective. Expenditure cuts are aggressive but overshooting could be cushioned by upside surprises in revenue such that the unchanged deficit target looks credible," they write.

KPMG Tax Services Sdn Bhd executive director Ng Sue Lynn, for one, sees upside for GST revenue collection in the coming years, even if the 6% rate remains unchanged.

All things considered, can Malaysia successfully expand its ability to provide a wider social safety net for the low and middle-income groups as well as the so-called "urban poor" who might well be highly leveraged professionals?

To be sure, private consumption could be boosted by as much as RM8 billion, allowing private sector wage earners to choose to cut their statutory contribution to the Employees Provident Fund (EPF) by 3% to 8% (from March 2016 to December 2017); even GST collection could increase. The move could well provide a much-needed RM100 or so extra spending money a month to the low and middle-income group. Yet those who choose to spend the money up front would likely do so at a cost higher than the banks' base lending rate. Not only will they lose the dividend income from the EPF but some might also end up having to pay even more personal income tax — especially if their income tax bracket moves up. This could be the case for those earning RM4,000 a month (see sidebar).

Changes to Budget 2016

	2015 (RM BIL)	2016 (RM BIL)	2016 (RM BIL)	
	ACTUAL	BUDGETED	REVISED BUDGET	
Brent crude (US$/barrel)	52	48	35	30
Revenue	219.1	225.7	217.9	216.3
Operating expenditure	217	215.2	211.2	210.7
Current account balance	2.1	10.4	6.7	5.6
Development expenditure	40.8	50	46	45
(Loan recoveries)	-1.5	-0.8	-0.8	-0.8
Overall balance:	-37.2	-38.8	-38.5	-38.7
as a % to GDP	-3.2	-3.1	-3.1	-3.1
Federal government debt (% to GDP)	54.3	52.2	52.5	52.7

"Cutting employees' contribution to the EPF when it is deemed to be insufficient for retirement can only be a short-term measure to boost economic growth. But it also shows the government is running out of policy ammunition and is struggling with measures to paint a decent growth picture of the economy," says a seasoned economist.

This puts the spotlight back on Najib's "we are all doing this together for our nation" call to Malaysians to do their bit for the country's economy. While this could be when all Malaysians should ask themselves what they can do for the country, the government will need to ensure it continues to have great flexibility to provide for the people when they ask what the country can do for them in their time of need. To do this, policymakers need to ensure the nation's assets are prudently used and its cash flow never runs dry.