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ECONOMIC REPORT | Budget 2017

Budget 2017 Expectation: Practical and Prudent Budget

- *In line with the current economic development, we are expecting that Budget 2017 will focus on three issues i.e. economic growth, welfare and prudent spending. One would realise that targeting for higher economic growth is not really in line with prudent spending; however there are a few strategic measures which could stimulate the economic activity in the short term with relatively low cost by the Government.*
- *Since July 2016, Malaysia fiscal performance has been much better than the first half of 2016, in which we are convinced that the Government will be able to achieve the 3.1% to GDP fiscal deficit target this year. As we believe that the Government is keen in keeping with the fiscal consolidation plan, we are expecting that the Government will continue to aim for a lower fiscal deficit target for year 2017 at 3.0% to GDP.*
- *2017 is expected to be a better year for Malaysia. Subsiding external headwinds and stabilizing in commodities prices will lend supports to both domestic and external sectors. These positive developments will bode well with the anticipation of higher government revenues for 2017 as well as the smooth implementation of proposed initiatives line-up in the upcoming budget.*

Budget 2017 will be about economic growth, welfare and prudent spending. In line with the current challenging economic outlook, we are expecting that Budget 2017 will focus on three main issues i.e. rejuvenating economic growth, addressing people's wellbeing and as well as maintaining discipline and prudent fiscal spending. One would realise that targeting for higher economic growth is not really in line with prudent spending; however there are a few strategic measures which could be adopted by the government to stimulate domestic economic activity at least in the short term with relatively low impact toward its finance.

Table 1: Federal Government Finance

	RM million				YoY change			
	2015	**2016f**	**2016f Revised**	**2016 Actual (Jan-Aug)**	**2015**	**2016f**	**2016f Revised**	**2016 Actual (Jan-Aug)**
Oil Price	$50	$48	$30	$43	$50	$48	$30	$43
Revenue	219,100	225,656	216,300	135,131	0.8%	1.4%	(1.3%)	(5.6%)
Expenditure	256,300	264,439	254,900	165,573	(0.1%)	3.2%	(0.5%)	3.4%
Overall balance	(37,200)	(38,783)	(38,600)	(30,442)	0.4%	(4.3%)	(3.8%)	(80.3%)
Overall balance as % of GDP	**(3.2)**	**(3.1)**	**(3.1)**	**NA**	-			

Source: BNM, CEIC, MIDFR

Budget deficit target of 3.1% and 3.0% for year 2016 and 2017 respectively. Due to a broad-based slowdown in global trade activity along with depressed commodity prices and geopolitical uncertainties, 2016 has been a very challenging year for the Government. Until August 2016, total revenue was down by 5.6%yoy, while total expenditure continues to increase by 3.4%. The contraction in revenue collection is higher than the recalibrated budget expectation of -1.3%yoy. On the other hand, total expenditure spiked by 3.4% against the -0.5%yoy for full year expenditure expected for 2016. However, noticeably since July 2016, Malaysia fiscal performance has been improving compared to the first half of 2016. In line with our anticipation of better performance for the 2nd half of the year, we are convinced that the Government will be able to achieve fiscal deficit target of 3.1% this year. As for the fiscal consolidation plan, we are expecting that the Government will continue to strive for a lower fiscal deficit target for year 2017 at 3.0% to GDP.

Government Finance

GST revenue will be slightly higher at RM40 billon in 2017. Up until the latest available data i.e. 2Q16, GST collection has been below expectation, with a total collection of RM17.2 billion in 1H16, against the expectation of RM39.0 billion for full year 2016. Presently, our estimate for 2016 GST collection is at RM37 billion. However, we expect that GST collection will continue to grow next year in anticipation of improved domestic economic environment. We estimate the full year collection of GST to be slightly higher at RM40 billion in 2017. We are also anticipating that would not be any major changes in the GST structure in this budget. However, slight changes can be expected from the list of exempted goods and services. Possible uplifting of some of the exempted goods and services from the list is possible.

It is unlikely to be any change on the corporate tax this year, but there might be some change for the income tax. Similarly, due to the challenging economic environment that negatively impacted Government coffer, we opine there will be remote possibility of any change in regards to the corporate tax structure. However, incentives can be expected for certain targeted sectors like housing, tourism and agricultural. In respect to personal income tax, possible positive moves for the tax payer may include among other an increase in the amount of the tax relief from the existing list. In addition, the budget may implement some temporary measures that could lift the burden of the M40 group, particularly the younger workers, such as exclusion of income tax payment for the first year of working and a slightly higher minimum income tax requirement. These possible measures will boost the disposable income of the targeted groups which in return will eventually translate into higher domestic consumption.

Unlocking and optimizing the value of Government asset. It is known that the Government possess a lot of assets in particular tangible assets in the form of buildings and land. In order to boost Government revenue to cope with the challenging times ahead, Government may choose to begin by unlocking the value of their assets. These assets can be utilised to generate revenues for the Government through leasing to the private sector. These assets will then be able to be utilised to spur economic activity which will contribute to the overall economic growth of the country.

Economic Growth

Protecting the domestic industry. There is a rising concern regarding Malaysia's current account status, which has been showing a clear downward trend over the past few years. The downward pressure on the Ringgit due to the normalisation plan by the US central bank and other external and domestic factors in play increased the concern of policy makers on the possibility of a twin deficit next year. As such, some form of measures to protect our domestic content and reduce reliance of imported products may be introduced, or at least encouraged. Among others, there may be measures to boost tourism industry, which is regarded as an ideal sector to boost and improve our current account balance.

Stimulus to improve lending activity. There has been a clear downtrend since early this year on the approved lending activity by the banks. Financial institutions have becoming stringent in extending facilities due to unfavourable economic outlook. The sectors that have been directly affected by this cautious approach are property and auto industry. We believe there will be more measures to address the needs of first time home buyers in this coming budget. Among the possible measures are higher percentage contribution for EPF account 2 of which then be used to finance the house purchase. The measure can be implemented based on the targeted timeline of which once the contributor be able to purchase the first house, the percentage contribution will then be reverted to the previous allocation. Furthermore, a new first time car buyer scheme may also be introduced, where those who are qualified may be exempted from paying the excise duty. This move if implemented will have a positive short-term impact toward auto and banking sector barring its possible long-term shortcomings.

Measures to reduce dependency of foreign labour. It is inevitable that as Malaysia is moving toward becoming a high income nation. Thus, sustained dependency on cheap and low-skilled foreign labours is not within the equation. Assistance from the Government is inevitable that most businesses especially SMEs are finding it difficult to survive without relying on foreign labour. There are two possible approaches which can be adopted by the Government to resolve the foreign labour dependency, i) through providing incentives such as tax rebate to companies which shift to automation and/or mechanisation and ii) provide loans with low interest rate and longer tenure to companies seeking for financing their automation/mechanisation. To oversee this foreign labour related implementation, a clear and practical roadmap for each individual sector need to be drawn. A set of targeted timeline for the industries to gradually move toward automation is needed.

Welfare

The 1Malaysia People's Aid (BR1M) will continue to increase next year. As promised by Dato' Sri Najib, BR1M's handouts will continue to increase gradually every year until it reached RM1,200 for the qualified household. At the moment, those with household income of RM3,000 and below is qualified for RM1,000 assistance a year. We believe the amount will be increased to between RM1,050 – RM1,100 for next year, in order to gradually attain the promised RM1,200 assistance.

2017 is expected to be a better year for Malaysia. Subsiding external headwinds and stabilizing in commodities prices will lend supports to both domestic and external sectors. These positive developments will bode well with the anticipation of higher government revenues for 2017 as well as the smooth implementation of proposed initiatives line-up in the upcoming budget.

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