# Malaysia 2020 Budget Preview

## A Second Chance to Mend the Economy and to Restore Confidence

### OVERVIEW

- **Restoring public confidence**. Budget 2020, the second edition of the fiscal budget formulated under the Pakatan Harapan-led government, would be an opportune platform for the government to reaffirm its policy stance, to provide a clearer direction of its long term development plan and to restore public confidence towards its administration.
- **Turning point**. To be tabled on 11th October, Budget 2020 will be the final budget under the 11th Malaysia Plan (2016-2020) which also marks a turning point for Malaysia as it transitions towards a new era post Wawasan (Vision) 2020. It will face a challenging backdrop of elevated uncertainty and potentially deeper global economic slowdown.
- **Tenuous growth outlook**. Assuming that the government has factored in all the external and domestic factors**, we reckon the official GDP forecast for 2020 would be biased on the low side between 4.0%-4.5% (KIBB forecast: 4.3%)** compared to this year's forecast of 4.3%-4.8% (KIBB forecast: 4.5%) which would likely be adjusted.
- **Sharing is caring**. Themed "Shared Prosperity: Sustainable and Inclusive Growth towards High Income Economy", the budget would propose measures aimed at narrowing various facets of inequalities and raise the standard of living for all citizens.
- **Pragmatic approach.** With limited fiscal space, a challenging external environment and an unsettled new administration, we expect policy makers will take a realistic, attentive and responsible approach in the coming budget.
- **Another tough budget amid external headwind.** We expect the upcoming budget to remain expansionary despite the government's plan to continue to implement fiscal discipline via Medium-Term Fiscal Framework from 2019 to 2021.
- **An expansionary budget without compromising on fiscal consolidation** would entail a challenging budget. Hence, this would imply a baseline fiscal deficit projection of 3.3% of GDP in 2020 (versus a deficit forecast of 3.5% in 2019, wider than the initial 2020 deficit target of 3.0% that was highlighted in the Budget 2019)
- **Contingency against external shocks.** To safeguard the domestic economy from external shocks, the government is expected to set aside between RM5.0b-RM10.0b in the form of contingency fund in upcoming budget for next year. In the event of a sharp economic slowdown or a likelihood of global recession**, a full drawdown of the contingency fund would result in the fiscal deficit to widen to 3.6%-3.9% of GDP**.
- **Debt to remain manageable**. As the government needs slightly less debt to finance next year's deficit, we reckon the federal government debt, which hit a record high of RM799.1b or 52.7% of GDP in 1H19, to still remain below its self-imposed limit of 55.0% of GDP in 2020.
- **No new tax and a softer revenue in 2020**. In the forthcoming budget, we reckon the targeted 2020 revenue would soften to RM240.9b, attributable to limited revenue enhancement options and the absence of another large one-off RM30b special dividend from Petronas.
- **Oil-related revenue to face pressure amid lower oil price outlook in 2020.** The government will likely revise its oil price assumption down from USD70/barrel to a more realistic range of USD60-65/barrel for the year 2020, versus our in-house forecast of **USD60/barrel (2019F: USD65/barrel).**
- **Non-tax revenue to play an even more important role in compensating for the shortfall in tax revenues.** Specifically, we are pencilling in greater contribution from the monetisation of idle and underutilised assets. The other being the possibility that the government may decide to hike the levy on foreign workers.
- **Focused and targeted.** Emphasis would be given to the low income group (B40), the youth as well as small- and medium-sized enterprises (SMEs). Areas that may be highlighted in the upcoming budget are: 1) education and training to boost labour productivity; 2) infrastructure projects to spur construction activity; 3) incentives for investment in green technology and green financing; 4) more incentives to raise the adoption of new technology and digitalisation; 5) promoting tourism to drive Visit Malaysia Year 2020; and 6) healthcare initiatives to reduce the public healthcare cost.

## CONTEXT

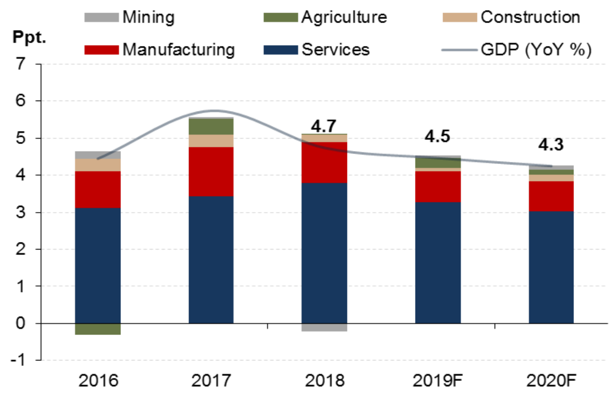
- **Restoring confidence.** Budget 2020, the second edition of budget formulated under the Pakatan Harapan government, is slated to be tabled at the Parliament on Friday, October 11th. This would be an opportune platform for the government to reaffirm its policy stance, to provide a clearer direction of its long term development plan as well as a fresh attempt to restore public confidence towards the administration.

- **Heightened external risk a concern**. It will face a challenging backdrop of elevated uncertainty and potentially deeper global economic slowdown. Based on our projection, the economy is expected to endure further economic moderation next year, growing by 4.3% YoY (2019F: 4.5%), accompanied by rising headwinds to growth. Major concern remains on the US-China trade feud which has escalated to a new height with recent introduction of new tariffs by both the US and China on imports of each other's goods. The trade negotiation is expected to constantly oscillate between escalation and de-escalation of tension, heightening global uncertainty and financial market volatility in the near term resulting in delayed investment decisions that are crucial for growth.

- **Lower official growth projection for 2020**. While the external factors would weigh on Malaysia's growth prospect, it would partially be mitigated by domestic activities, in particular the revived mega infrastructure projects, providing the much needed multiplier factor to boost domestic demand. Assuming that the government has factored both external and domestic concerns, **we reckon the official GDP forecast for 2020 would be biased on the low side between 4.0%-4.5%** compared to this year's forecast of 4.3%-4.8% which would likely be adjusted.

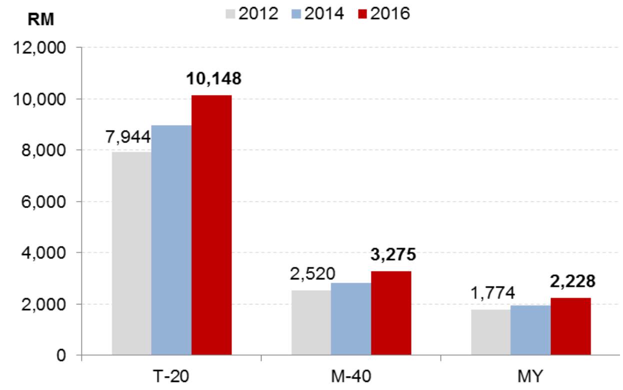
- **Turning point.** Budget 2020 marks a turning point for Malaysia as it transitions towards the 12th Malaysia Plan (12MP, 2021-2025) and a new era post Vision 2020**.** It is obvious that Malaysia would miss the target of becoming a developed nation by 2020. The prolonged global economic malaise and domestic economic mismanagement has pushed the target for Malaysia to achieve high income nation status by four years to 2024. In view of this, the government is due to unveil a new comprehensive strategy to achieve shared prosperity by 2030, which will incorporate both the 12th and 13th Malaysia Plans. We foresee some of the measures and policies announced in the budget to incorporate the gist of the 12MP, which is premised along the vision of Shared Prosperity 2030, encapsulating three development dimensions: economic empowerment, environmental sustainability and social re-engineering. These hover around the idea of tapping into new growth enablers in the era of 4th Industrial Revolution, whilst ensuring all segments of the citizens are able to participate and prosper from the economic activities, in addition to simultaneously improve and focus on sustainability. To be released in mid-2020, the 12MP would also prioritize regional development particularly in six seemingly left-behind states, namely Sabah, Sarawak, Perlis, Kedah, Kelantan and Terengganu.

**Graph 1: GDP by Sector**



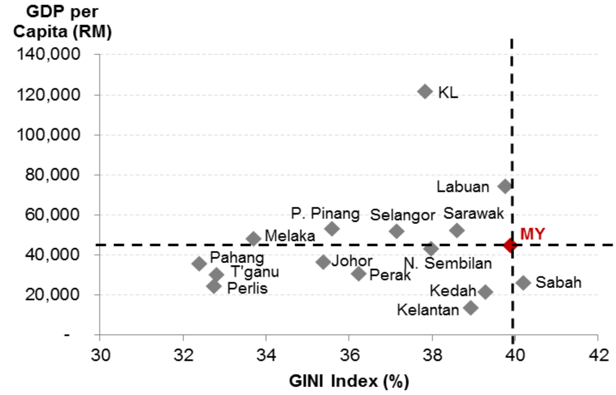

*Source: Dept. of Statistics, Kenanga Research*

**Graph 2: Household Income Gap Relative to B-40**




*Source: Dept. of Statistics, Kenanga Research*

**Graph 3: Income vs. Inequality**




*Source: Dept. of Statistics, Kenanga Research*

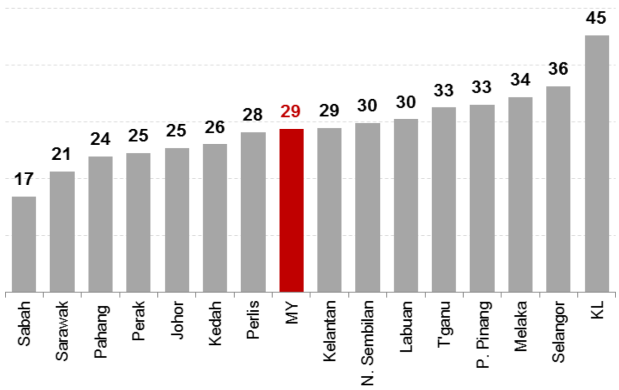
### Table 1 : Real GDP by Sector - Trend and Forecast (%YoY)

| % YoY Growth | 2016 | 2017 | 2018 | 1Q19 | 2Q19 | Kenanga 3Q19E | 4Q19F | 1H19 | 2H19F | 2019F | 2020F | MoF 2019F | BNM 2019F |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| By Sector | | | | | | | | | | | | | |
| Agriculture | -3.7 | 5.7 | 0.1 | 5.6 | 4.1 | 3.0 | 2.1 | 4.9 | 2.6 | 3.7 | 2.0 | 3.1 | 0.1 |
| Mining | 2.2 | 0.4 | -2.6 | -2.1 | 2.9 | 1.5 | 1.3 | 0.3 | 1.4 | 0.8 | 1.5 | 0.7 | -2.6 |
| Manufacturing | 4.4 | 6.0 | 5.0 | 4.1 | 4.3 | 3.4 | 3.1 | 4.2 | 3.2 | 3.7 | 3.7 | 4.7 | 5.0 |
| Construction | 7.5 | 6.7 | 4.2 | 0.3 | 0.5 | 2.8 | 4.6 | 0.4 | 3.7 | 2.1 | 3.6 | 4.7 | 4.2 |
| Services | 5.7 | 6.2 | 6.8 | 6.4 | 6.1 | 5.6 | 5.0 | 6.3 | 5.3 | 5.8 | 5.3 | 5.9 | 6.8 |
| Real GDP | 4.4 | 5.7 | 4.7 | 4.5 | 4.9 | 4.4 | 4.0 | 4.7 | 4.2 | 4.5 | 4.3 | 4.9 | 4.3-4.8 |

*Source: Ministry of Finance, BNM, Kenanga Research, E: Estimate F: Forecast*
*Note: BNM forecast in March 2019, while MoF forecast was in November 2018*

- **Sharing is caring**. Themed as "Shared Prosperity: Sustainable and Inclusive Growth towards High Income Economy", the budget measures will aim to narrow various facets of inequalities, ensuring decent standard of living for all citizens. As defined by the World Bank, shared prosperity is the "average annual growth in income of the poorest 40% within each country", often coined together with the term "shared prosperity premium" defined as the "difference between the annual income growth rate of the B-40 and the mean in the economy". Shared prosperity aims to track the pervasiveness of inequality in an economy, which could be viewed in several angles among others, disparities across income groups and across states. Malaysia has experienced a rising disparity across income groups, with widening gaps between median monthly household income of T-20 (2016: RM10,148; 2012: RM7,944), M-40 (2016: RM3,275; 2012: RM2,520) and Malaysia's average (2016: R2,228; 2012: RM1,774) relative to the B-40. Cross-states, GINI index varies from 32.4% in Pahang to 40.2% in Sabah, with income per capita ranging from RM13,668 in Kelantan to RM121,293 in Kuala Lumpur. The abovementioned disparities could give rise to variation in educational attainment, employability and business opportunity.

### Graph 4: Tertiary-Educated Labour Force (% share)

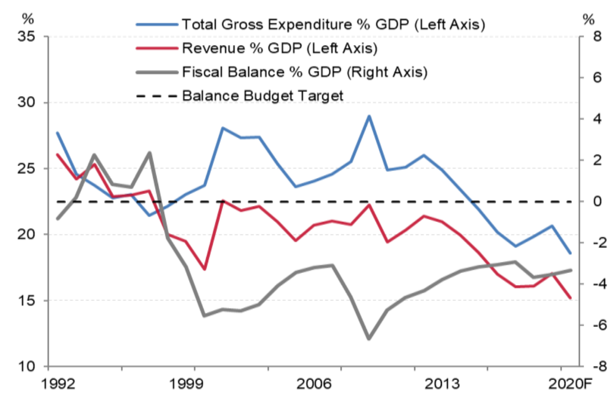



*Source: Dept. of Statistics, Kenanga Research*

## DEFICIT OUTLOOK

- **Another tough budget amid external headwind.** We expect the upcoming budget to remain expansionary despite the government's plan to continue to implement fiscal discipline via Medium-Term Fiscal Framework (MTFF) from 2019 to 2021. This would be difficult for the government mainly due to the expectation of rising external risk which may weigh on economic growth. In fact, Finance Minister Lim Guan Eng said it would be challenging for the nation to meet the 3.0% fiscal deficit target in 2020 and the government is ready to provide contingency measures to insulate Malaysia from any adverse impact from the US-China trade feud. Nonetheless, we expect the government to continue with its expenditure optimisation exercise to curb wastages and leakages while specifically targeting value-added projects that offer higher multiplier impact.

### Graph 5: Fiscal Balance Sheet Ratio Trend

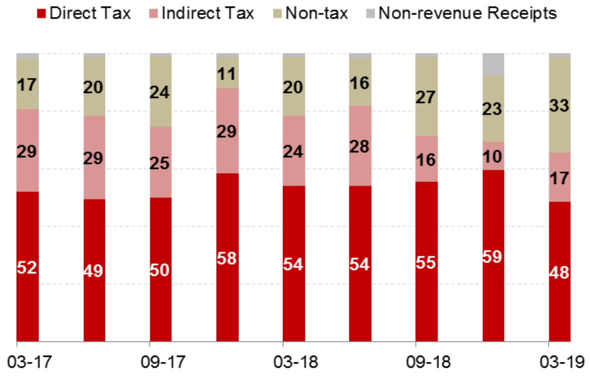



*Source: MoF, Kenanga Research*

- **Pragmatic approach.** With limited fiscal space, a challenging external environment and an unsettled new administration, we expect policy makers would take a realistic, attentive and responsible approach in the coming budget. For the past 17 months, it has done a lot of work to clean up the financial mess created by the previous administration, restore public finances, beef up good governance, step up anti-corruption drive, adopt cost-effective ways of spending and rebuild fiscal buffers. An expansionary budget without compromising on fiscal consolidation would entail a challenging budget. Hence, this would imply a baseline fiscal deficit projection of 3.3% of GDP in 2020 from a forecast -3.5% in 2019, wider than the initial deficit target of 3.0% that was highlighted in budget 2019 and even far off the balance budget target set in the 11MP.

- **Lower oil price outlook pose a downside risk for fiscal management.** The oil and gas (O&G) revenue account for about 30.0% of total fiscal revenue based on projected average crude oil price of USD60-65/barrel for this year. This is relatively significant and could put a strain on the fiscal health if crude oil price dip below USD60/barrel this year. Given the slower global demand for carbon fuel, and the rising global crude oil supply as a result US exporting its surplus petroleum and the ineffectiveness of Organisation of Petroleum Countries (OPEC) planned production cuts, the price outlook for oil next year is likely to be lower and to average around USD60/barrel. The absence of Petronas' one-off RM30.0b special dividend, lower corporate earnings and a slower growth prospect next year, the government may need to stretch its budget to achieve a lower fiscal deficit target.

**Graph 6: Government Revenue Breakdown (% share)**




*Source: BNM, Dept. of Statistics, Kenanga Research*

- **Contingency against external shocks.** To safeguard the domestic economy from external shocks, the government is expected to set aside between RM5.0b-RM10.0b in the form of contingency fund in upcoming budget for next year. Like in the previous two stimulus packages in 2008 (Nov) and 2009 (Mar), it is aimed to cushion the Malaysian economy from any adverse impact of the protracted US-China trade tension and Black Swans (random adverse economic events). This could largely be channelled to development expenditure via public spending on infrastructure project which would catalyse private spending and investment to kickstart the multiplier effect. As previously, it includes a direct spending package, other measures and incentives that cover government guarantee funds, private finance initiatives, and off-budget projects. **In the event of a sharp economic slowdown or a likelihood of global recession, a full drawdown of the contingency fund would result in the fiscal deficit to widen to 3.6%-3.9% of GDP**. This, we reckon, would not trigger a sovereign rating downgrade as it is a counter cyclical measure to cushion a negative impact of a sharp economic slowdown.

## DEBT MANAGEMENT

- **Managing deficit financing.** With total expenditure (Operating + Development expenditure) is projected to edge up over total revenue, we expect the fiscal deficit to remain large albeit to narrow to 3.3% of GDP or RM51.9b from our forecast of 3.5% of GDP (RM53.9b) for 2019 (MoF forecast: 3.4% of GDP or RM52.1b). This means the government would need about RM2.0b less to finance the deficit in 2020 compared to 2019.

**Table 2 : Federal Govt Debt, Liabilities and Guarantees**

| | End-Period (RM Bil) | | End-Period (% of GDP) | |
|---|---|---|---|---|
| | 2017 | 2018 | 2017 | 2018 |
| Federal government debt (Direct Debt) | 686.8 | 741.0 | 50.1 | 51.2 |
| Other liabilities (PPPs, PFIs and PBLT) | 260.1 | 184.9 | 19.0 | 12.8 |
| Government guarantees to be serviced | 102.1 | 132.7 | 7.4 | 9.2 |
| 1Malaysia Development Bhd (net debt)* | 38.3 | 32.2 | 2.8 | 2.2 |
| Total debt and liabilities | 1087.3 | 1090.8 | 79.3 | 75.4 |

*Source: 2018 Public Accounts Committee (PAC) Report, JANM Reports, MoF, Bloomberg,*
** Principal amount (excluding interest)*

- **Debt to remain manageable**. As the government needs slightly less debt to finance next year's deficit we reckon the federal government debt, which hit a record high of RM799.1b or 52.7% of GDP in 1H19, to still remain below its self-imposed limit of 55.0% of GDP in 2020. The government's external debt in foreign currency, which has reached RM24.4b in 1H19, is also expected to remain under the RM35.0b threshold this year and the next. Meanwhile, the government guaranteed debt is also at its highest at RM273.8bn or 18.1% of GDP in 1H19. To improve its overall debt and liability management and credit risk, we believe it is a matter of time that the government may introduce a self-imposed limit on government guaranteed debt. That will gain brownie points from foreign investors and rating agencies. Nonetheless, the overall debt and liabilities is expected to remain relatively high or above 70.0% of GDP in 2019 and 2020 but possibly below 2018's level of RM1.09 trillion or 75.4% of GDP. It peaked in 2017 at 79.3% of GDP. The other factor that should be of concern is the mounting debt service charge which has ballooned to a record RM30.5b in 2018.

**Table 3 : Federal Government Finance Trend and Forecast**

| | | | | | | | MoF | KIBB | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **(RM billion)** | **2013** | **2014** | **2015** | **2016** | **2017** | **2018** | **2019F** | **2019F** | **2019F*** | **2020F** |
| Revenue | 213.4 | 220.6 | 219.1 | 212.4 | 220.4 | 232.9 | 261.8 | 257.9 | 220.9 | 240.9 |
| Total Expenditure | 253.5 | 259.1 | 257.8 | 252.2 | 262.6 | 287.1 | 314.6 | 312.8 | 275.8 | 292.8 |
| Operating Expenditure | 211.3 | 219.6 | 217.0 | 210.2 | 217.7 | 231.0 | 259.9 | 256.9 | 219.9 | 238.9 |
| Gross development Expenditure | 42.2 | 39.5 | 40.8 | 42.0 | 44.9 | 56.1 | 54.7 | 55.9 | 55.9 | 53.9 |
| Loan Recoveries | -1.5 | -1.1 | -1.5 | -1.3 | -1.9 | -0.8 | -0.7 | -1.0 | -1.0 | -1.0 |
| **Overall Balance** | **-38.6** | **-37.4** | **-37.2** | **-38.4** | **-40.3** | **-53.4** | **-52.1** | **-53.9** | **-53.9** | **-51.9** |
| ***% of GDP*** | **-3.8** | **-3.4** | **-3.2** | **-3.1** | **-2.9** | **-3.7** | **-3.4** | **-3.5** | **-3.5** | **-3.3** |
| Federal Government Debt (% of GDP) | 54.7 | 52.7 | 54.5 | 52.7 | 50.7 | 50.7 | 51.8 | 53.0 | 53.0 | 54.5 |
| **Real GDP Growth** | **4.7** | **6.0** | **5.0** | **4.2** | **5.9** | **4.7** | **4.9** | **4.5** | **4.5** | **4.3** |
| Average Crude Oil Price (US$/Barrel) | 108.7 | 99.5 | 53.6 | 45.1 | 54.2 | 70.0 | 60-70 | 65.0 | 65.0 | 60.0 |

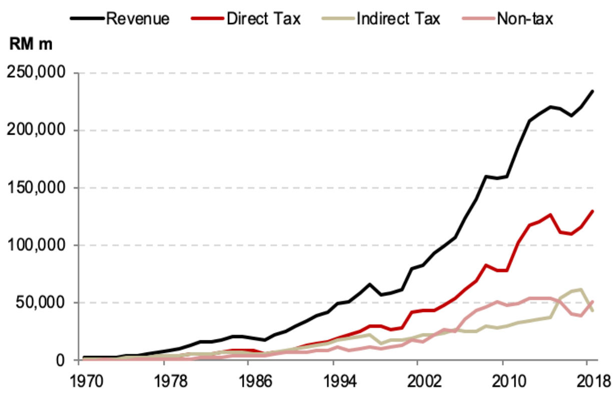
Source: Ministry of Finance Budget 2019, BNM, Kenanga Research, Crude Price are based on forecast, * Less Tax Refund (GST + Income Tax)= RM37.0b

## REVENUE

- **So far so good**. In the 1H19, fiscal revenue expanded by a hefty 17.8% YoY (1H18: 10.0%) to RM125.8b (1H18: RM106.8b), coming in at 48.0% (1H18: 44.5%) of the targeted revenue for 2019. According to the breakdown available for the 1Q19, the higher revenue collection was underpinned by an increase in non-tax revenue, mainly in the form of interest and investment return. This was within expectation as Budget 2019 outlined a special dividend from Petronas, totalling RM30.0b for this year to mainly settle tax refunds on top of the annual dividend of RM24.0b. As per historical trends, we expect revenue to edge higher in 2H19, though it may fall short of the full year official target of RM261.8b, given that Brent crude oil remained relatively low, averaging at USD64.8/barrel (Jan-Sep 2019), below the official assumption of USD70/barrel and an expected slower economic growth.

- **No new tax and a softer revenue in 2020**. In the forthcoming budget, we reckon the **targeted 2020 revenue would soften to RM240.9b, attributable to limited revenue enhancement options and the absence of another large one-off RM30b special dividend from Petronas.** With regards to taxes, the Finance Minister has repeatedly stated that, unlike in 2019, there will be no introduction of new tax measures next year. This, coupled with prospect of further economic moderation in 2020, result in our view of **softer growth in overall tax revenue collections.** Nonetheless, the slowdown in growth of corporate and individual tax revenue is expected to be partially mitigated by a wider tax base, a surprising 490,000 tax declarations (as of June 2019), from both existing and newly-registered tax payers, have been received by the Inland Revenue Board through the Special Voluntary Disclosure Programme (SVDP).

**Graph 7: Government Revenue Trend**




*Source: BNM, Department of Statistics, Kenanga Research*

- **Digital tax cometh.** Services tax revenue would also receive some support from the **6.0% tax on imported digital services (estimated collection: RM2.4b per year)** which has been announced in the Budget 2019 and scheduled to be implemented on 1st January 2020. We view this as a commendable move as not only that it would create a new source of revenue for the government, but it also helps to even the playing field for the local players in the digital industry, correlating with the country's agenda to develop the digital economy.

- **Oil-related revenue to face pressure amid lower oil price in 2020.** The government will likely revise its oil price assumption down from USD70/barrel to a more realistic range of USD60-65/barrel for the year 2020, versus our in-house forecast of **USD60/barrel (2019F: USD65/barrel).** Petroleum revenue, encompassed of income tax, export duty, royalties and ancillary income from Petronas, is forecasted to track the weakening in Brent crude oil prices projected for next year, as demand for oil is expected to wither in an environment of softer growth and as bouts of risk-off sentiments may be triggered by elevated geopolitical tension. Premising on the government's estimate of RM0.3b change in revenue for every USD1.0 change in the price of oil, we foresee oil-related revenue to decline by about RM1.5b, knocking off around 1.0% of its share of total revenue.

- **Non-tax revenue to play an even more important role in compensating for the shortfall in tax revenues.** Specifically, we are pencilling in **greater contribution from the monetisation of idle and underutilised assets**, as lauded by the Prime Minister Tun Dr Mahathir Mohamad. To overcome the over-reliance on foreign labour, whereby the size of registered foreign worker has crossed over 2.0m, the government may decide to **hike the levy on foreign workers** from the current annual fee of RM1,850 for the first 10 years and an annual extension fee for the next 3 years ranging from RM2,000 (plantation, agriculture) to RM6,000 (construction, manufacturing and services sectors). We view that the hikes would likely be executed on a multi-tiered basis, similar to what the Home Ministry and Human Resource Ministry have planned for beginning 1st January 2020. This is essential to induce employment of domestic workforce, through an expected favourable adjustment in wages for the low-skilled positions.

## EXPENDITURE - Targeted Spending

- **Final push in 2020?** We don't see there would be much the government can do for a last big push in the final year of the 11MP (2016-2020). Between 2016 and 1H19, the federal government has spent RM166.4b in development expenditure (DE), equalling to 75.6% of the 11MP target allocation of RM220.0b. Assuming the government use the entire RM54.7b budgeted for the whole of 2019, the balance of allocated DE spending would only be RM22.3b for 2020. This would obviously mean that the Government would need to top up as much as RM30.0b to meet the infrastructure spending needs in 2020 to drive growth.

- **Focused and targeted spending.** Given the fiscal constraints the spending and allocation of funds would be focused and targeted. To support the economy, we expect the government to focus on areas such as trade and industry, communications, healthcare, education and training, as well as infrastructure projects. Apart from the much-awaited revival of the High Speed Rail and MRT3 projects, the potential revival of the Johor Baru-Singapore Rapid Transit System Link (RTS) project could also be one of the key projects for next year. Furthermore, some of the 121 projects outlined for 2019 may be pushed through to next year due to delays caused by adopting a more transparent open tender process.

**Table 4: Education Spending As % of GDP**

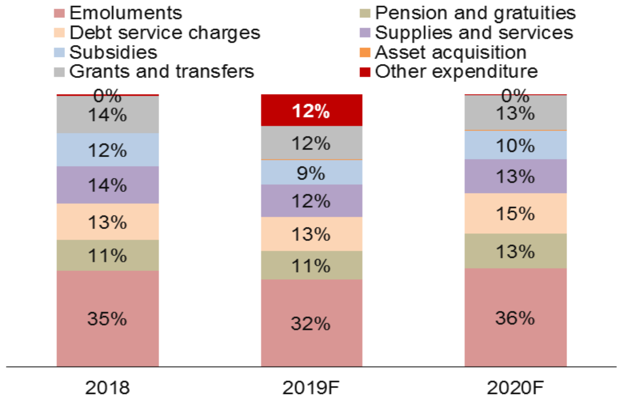
| | 2013 | 2014 | 2015 | 2016 | 2017 |
|---|---|---|---|---|---|
| Sweden | 7.7 | 7.7 | 7.6 | n/a | n/a |
| Finland | 7.2 | 7.2 | 7.1 | n/a | n/a |
| New Zealand | 6.7 | 6.3 | 6.3 | 6.3 | n/a |
| **Malaysia** | **5.5** | **5.2** | **5.0** | **4.8** | **4.7** |
| Australia | 5.2 | 5.2 | 5.3 | n/a | n/a |
| Thailand | 4.1 | n/a | n/a | n/a | n/a |
| Japan | 3.7 | 3.6 | n/a | 3.5 | n/a |
| Singapore | 2.9 | n/a | n/a | n/a | n/a |

*Source: World Bank, UNESCO Institute for Statistics, Kenanga Research*

- **Expenditure is expected to widen in 2H19, before it edges slightly down in 2020.** As of 1H19, the government has only utilised 43.7% (RM20.1b) of the RM54.7b development expenditure allocation, as well as 48.0% (RM124.8b) of the RM259.9b operating expenditure (OE) allocation, indicating some progress towards fiscal consolidation. Going into 2020, we foresee the total expenditure to increase to RM292.8b (2019: RM275.8b – KIBB forecast) partly due to normalisation effect arising from the one-off tax refund in 2019.

- **Trimming unnecessary subsidies,** by scaling up efforts to pursue targeted subsidy mechanisms. Greater focus is likely to be given to ensure the spending on subsidies or cash transfers are channelled to the right group of people, conditioned on productive activities, with a clearly specified sunset clause, as to alleviate any creation of moral hazard amongst the recipients. The government's policy of maintaining domestic fuel prices ahead and post-election has resulted in widening subsidies expenditure since 2018. Nonetheless, we expect the trend to be reversed approaching the end of this year and in 2020, contingent upon the much-awaited announcement on the implementation of targeted fuel subsidy mechanism together with the floating of domestic fuel prices. Of benefit to the government, the crude Brent oil price has been on a downtrend in 3Q19, trading below USD70/barrel (2018: USD75/barrel), which would reduce the subsidies burden for the government going forward. For the record, the federal government paid out RM4.9b on fuel subsidies for RON95 last year. This cost-saving measure would allow the government to spare a few billions to finance the stimulus package or social welfare spending, which may include increase in cash handouts via Bantuan Sara Hidup (BSH), benefiting about 4.1m households in the B-40 income segment. Additionally, an affordable home scheme for the rural and poor would likely be reviewed to ensure that cost and land/asset allocation is well managed.

**Graph 8: Federal Govt. Operating Expenditure**

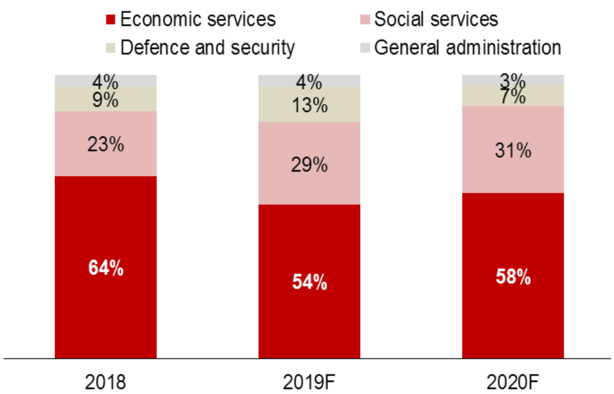



Source: BNM, Department of Statistics, Kenanga Research

- **Education remains a priority for the government**. In 2019, the government has put forth RM60.2b or 19.1% of total government spending toward the purpose of education. Regionally, Malaysia has among the highest share of education spending relative to GDP, though it continued to narrow for the past few years to 4.7% in 2017 (2016: 4.8%). In cognisant with the shared prosperity agenda, we believe the government would increase the education allocation further in the upcoming budget, using education as a tool to close the gaps amongst citizens of different strata. A portion of the allocation, amounting to RM1.5b would be directed to the "free breakfast" programme for primary schools, benefitting around 2.7m students of the primary level. Not to forget, initiatives to promote greater interest in the Technical Vocational Education and Training (TVET) among the youths are widely expected, to prepare them for the shift towards Industry 4.0. TVET has gained its relevance, given the need to ensure that the workforce is well-equipped with the demanded skills to thrive in the new industry.

- **Addressing youth unemployment and underemployment.** The youth unemployment rate in Malaysia currently stands at 10.9%, slightly higher than the national rate of 3.3% and has been increasing over the years. Of the 504,000 unemployed persons in 2019, almost 60.0% came from youth. Likewise, an increasing trend of job mismatches among the graduates has become a new norm, raising doubts whether graduates produced by the higher institutions match with what the industries need. We expect the government to tackle these issues in the Budget 2020 in the form of up-skill schemes in an effort to enhance youths' employability. Professional Training and Education for Graduating Entrepreneurs (PROTEGE) which has replaced the 1Malaysia Training Scheme (SL1M) early this year would need to be enhanced via greater participation among the industries especially the SMEs and jobs platform. Besides, the government may want to consolidate the numerous existing programmes such as Structured Internship Programme (SIP) and Graduate Enhancement Programme for Employability (GENERATE 2.0) under one ministry, allowing for scalability and maximisation of productive usage of resources.

**Graph 9: Federal Government Development Expenditure**




Source: BNM, Department of Statistics, Kenanga Research

- **Managing rising pension and gratuities.** With the ballooning number of government servants and rising life expectancy, burden for pension and gratuities payment is expected to increase significantly going forward. The expenditure for this component has increased from RM10.0b in 2008 (6.5% of OE) to RM25.2b in 2018 (10.9% of OE) and is projected to reach RM26.6b in 2019 (government forecast). Moving forward, as pensioners live longer and increase in number, the portion for this component is expected to continue to increase and eat into a bigger chunk of the government coffers in 2020, reaching a projected 13.0% share of total OE. This needs to be addressed via a comparative analysis of the various pension schemes globally for best practice, followed by a tailoring of a new pension scheme that suits the unique features of the Malaysia's public sector.

- **Boosting domestic investment while attracting foreign investment.** While the approved foreign investment rose to 86.5% in the 1H19 this year, the realised inflow of FDI remained weak, dropping by 5.0% YoY during the period (2H18: -22.0%). Meanwhile, domestic investments are still sluggish, waiting for policy clarity and direction from the government. To prop up the investment activity in 2020 and to benefit from any trade diversion amid the US-China trade war, we expect the government to announce a **special incentive package, to pull high-quality investment from MNCs that are looking to relocate their regional base.** Grants would also be directed to new growth areas aimed under the shared prosperity initiative, mainly focussing on digital economy, followed by aerospace, smart agriculture, and support services.
- **Embracing the digital economy.** According to Microsoft Malaysia, the digital economy contributes 16.8% of Malaysia's GDP. Meanwhile, the government is aiming to widen the share to 20.0% of GDP by 2020. This could be achieved through expansion in co-investment fund as well as industry digitalisation transformation fund in the targeted focus area. We view that that additional revenue from the tax on imported digital services which will kick-off on 1st January 2020 could be utilised to finance part of this fund.
- **Visit Malaysia 2020 to drive tourism activities.** It is likely that the government will allocate a significant budget for this sector in terms of promotion efforts and a special fund to assist SMEs in the related activities. This includes infrastructure spending specifically to facilitate development and uplifting of new and existing tourism attractions. Additionally, we may see some easing in the departure levy for domestic-bound flights, as a tool to prop up the domestic tourism sector. These measures will push the government closer to its aim of achieving 30.0m tourist arrival and RM100.0b tourist receipts under Visit Malaysia 2020. In 2018, Malaysia received a total of RM84.1b in tourist receipts from 25.8m foreign tourists, contributing 14.9% of GDP.

**For further information, please contact:**

**Wan Suhaimie Wan Mohd Saidie**
Head of Economic Research
wansuhaimi@kenanga.com.my

**Atiqa Noor Azlan**
Economist
atiqa.noorazlan@kenanga.com.my

**Muhammad Saifuddin Sapuan**
Economist
saifuddin.sapuan@kenanga.com.my



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**KENANGA INVESTMENT BANK BERHAD (15678-H)**
Level 17, Kenanga Tower, 237, Jalan Tun Razak, 50400 Kuala Lumpur, Malaysia
Telephone: (603) 2172 0880 Website: www.kenanga.com.my E-mail: research@kenanga.com.my

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