BUDGET 2021

National Budget 2021 Preview

5 NOVEMBER 2020

ECONOMIC RESEARCH

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BUDGET 2021

Main Focuses

1. The people's well-being
2. Business continuity
3. Economic resilience

- ✓ The national budget for 2021 will be tabled on 6 November 2020, with focus on revitalising the economy and aiming to protect lives and livelihood, as well as building on the current recovery momentum through economic stimulus packages.
- ✓ The coming budget will be the first budget under Malaysia's next five-year economic plan, the 12th Malaysian plan (12MP, 2021-2025).
- ✓ Businesses and households are now grappling with high numbers of Covid-19 pandemic cases which have led to movement restrictions, making Budget 2021 a tough call.
- ✓ In light of this, the government is expected to continue with its pandemic relief and stimulus initiatives in order to sustain the recovery process as the country faces headwinds from the third wave of Covid-19 infections.

FISCAL DEFICITS ARE EXPECTED TO INCREASE

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Federal Government Budgetary Position

RM Billion	2016	2017	2018	2019	2020E	2021F
Revenue	212.4	220.4	232.9	264.4	215.2	228.1
%chg	-3.0%	3.8%	5.7%	13.5%	-18.6%	6.0%
Operating Expenditure	210.2	217.7	231.0	263.3	264.5	269.8
%chg	-3.1%	3.6%	6.1%	14.0%	0.4%	2.0%
Current Balance	**2.2**	**2.7**	**1.9**	**1.1**	**-49.3**	**-41.7**
%chg	7.5%	20.6%	-29.1%	-44.2%	-4701.6%	-15.4%
Gross Development Expenditure	42.0	44.9	56.1	54.2	54.8	60.3
%chg	3.0%	6.9%	25.0%	-3.4%	1.2%	10.0%
Less: Loan Recoveries	1.3	1.9	0.8	1.6	1.1	1.6
Net Development Expenditure	**40.6**	**43.0**	**55.3**	**52.6**	**53.7**	**58.7**
%chg	3.5%	5.9%	28.5%	-5.0%	2.1%	9.3%
Overall Balance	**-38.4**	**-40.3**	**-53.4**	**-51.5**	**-103.0**	**-100.4**
% of GDP	**-3.1%**	**-2.9%**	**-3.7%**	**-3.4%**	**-7.1%**	**-6.5%**

Sources: CEIC, Bank Islam

- ✓ National Budget 2021 is expected to be an expansionary budget to support the country's recovery from the Covid-19 crisis. As such, we anticipate that the fiscal deficits would go up from an estimated 7.1% in 2020 to 6.5% in 2021 (2019: -3.4%). Thus far, the Ministry of Finance forecasted that fiscal deficits target to be at 5.8% to 6.0% of GDP in 2020. We expect this figure to be revised upwards.
- ✓ We anticipate that Operating Expenditure (OE) would also increase to RM269.8 billion in 2021 from RM264.5 billion in 2020 as the government will continue with its pandemic relief and stimulus packages.
- ✓ Apart from that, higher Development Expenditure (DE) is also anticipated (2020E: RM54.8 billion vs. 2021F: RM60.3 billion) as we believe the government would help the most affected sectors to rejuvenate the domestic economy in particular the construction sector which has plunged 44.5% during the June quarter this year.

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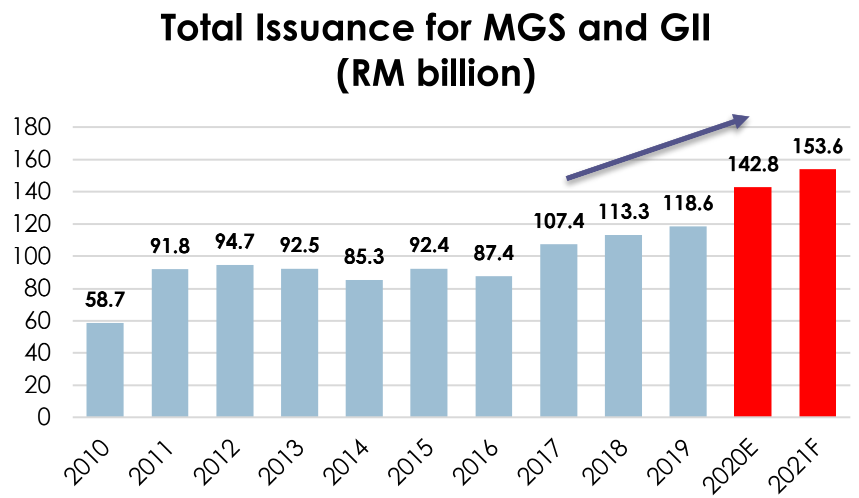
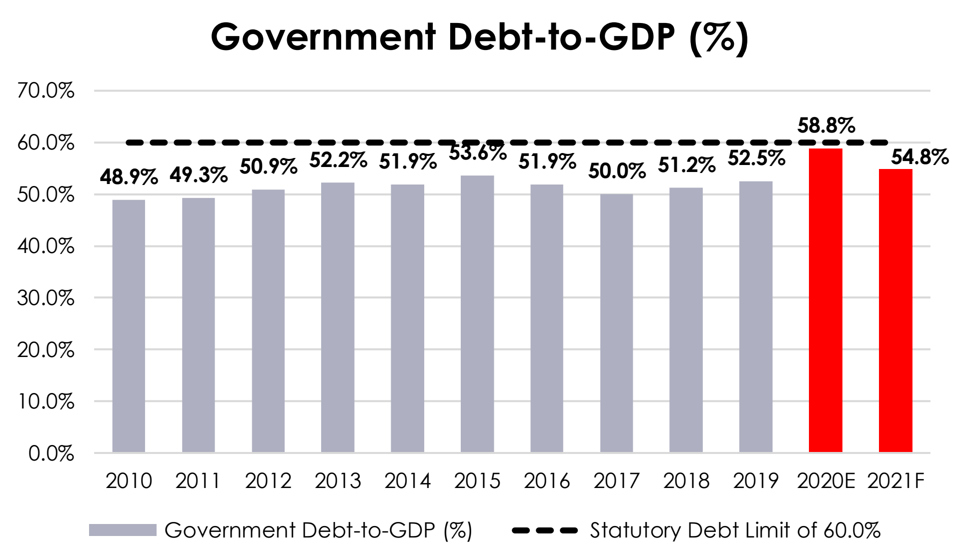


Sources: CEIC, Bank Islam

- ✓ The new issuance of local govvies (MGS and GII) is expected to increase to RM153.6 billion (10.0% of GDP) in 2021 from estimated RM142.8 billion (9.8% of GDP) this year.
- ✓ This is in view of the widening fiscal deficit due to the shortfall in government revenue amid low crude oil prices.
- ✓ As at the end of September, the total issuance of MGS and GII stood at RM126.6 billion (9M2019: RM95.2 billion), representing a 32.9% jump from same period last year.

- ✓ In addition, the government has raised the statutory debt limit from 55.0% to 60.0%, providing ample room to accommodate additional spending.
- ✓ The federal government debt is expected to be at 58.8% of GDP this year. However, in 2021, the debt-to-GDP ratio would likely to be lower at 54.8% as nominal GDP is expected to rise next year.
- ✓ The total government debt rose to a record RM854.1.0 billion as at the end of June 2020 with 96.0% raised from the domestic source.



Sources: CEIC, Bank Islam

KEY AREAS TO LOOK AT FOR BUGDET 2021

SMEs

1 Wage Subsidy Program (WSP)

-Needs to be continued to provide incentives to the employers in SMEs.

2 Prihatin Special Grant (GKP)

-Needs to be strengthened by targeting micro business in managing their revolving capital.

3 Retraining & Reskilling Program

-Has to be expanded so that many people are affected by Covid-19 to venture into business.

4 SME Digitalisation Grant

-Government may continue this initiative or expand it further to attract more SMEs in line with the prevalence of online shopping.

KEY AREAS TO LOOK AT FOR BUGDET 2021

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PROPERTY

1. Vacancy Tax

-Under review and not under high priority, letting the housing developers to manage the property overhang themselves.

2. Real Property Gains Tax (RPGT)

-Reducing the RPGT would encourage upgraders to enter the market and reassure investors that they will be able to keep more of their earnings.

3. Rent-to-own scheme

-Incentives for the B40 group such as the rent-to-own scheme and Youth Housing Scheme to continue into 2021 to help promote property ownership for the lower income group.

4. Home Ownership Campaign (HOC)

-Extend the campaign to ease the financial burden of the buyers.

KEY AREAS TO LOOK AT FOR BUGDET 2021

ENERGY

1

Continuous rollout of large-scale solar (LSS) programmes

- Distribution of projects to be more spread out and enable more industry players to benefit .

2

10-year 70% income tax exemption for solar leasing activities

- To spur interest and encourage more commercial participation in the adoption of renewable energy.

CONSTRUCTION

1

Rollover of mega projects worth RM143.1 billion announced in Budget 2020

-These include KL-Singapore HSR and the Penang Transport Master Plan.

KEY AREAS TO LOOK AT FOR BUGDET 2021

RUBBER GLOVES

Windfall Profit Tax (WPT)

-Widen the government revenue by levying a WPT on the glove manufacturers on their super normal profits. While this can be done, we believe it may not happen since it will send the wrong message to companies which have been very innovative in their business operation.

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TELECOMMUNICATIONS

National Digital Network Plan (JENDELA)

- Improve existing digital infrastructure and prepare the country for the transition to 5G.

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IMPACT-CREDIT RATINGS AND CURRENCY

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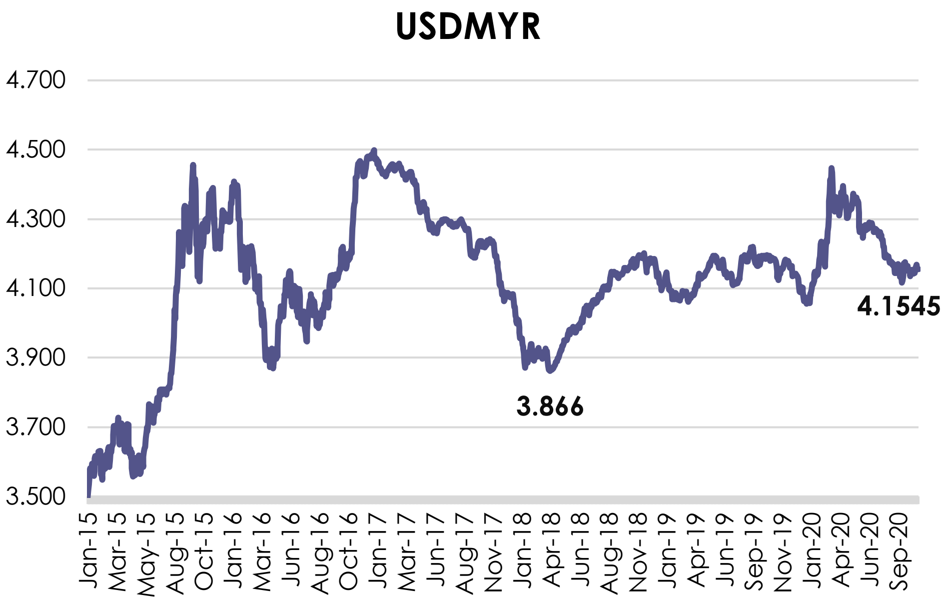

Sources: CEIC, Bank Islam

Malaysia's Sovereign Credit Ratings

Rating Agency	Credit Rating	Rating Outlook
Fitch Ratings	A-	-Downgraded to "Negative" from "Stable". - Effects of Covid-19 pandemic on exports earnings and partial lockdown on domestic economic activity.
S&P Global Ratings	A-	-Downgraded to "Negative" from "Stable". -Heightened risks to fiscal metrics due to the Covid-19 pandemic.
Moody's Ratings	A3	-Affirmed "Stable" rating outlook. - Diverse economy with robust growth potential and large domestic savings.

Sources: Rating Agencies

- ✓ Despite the higher public debt ratio that will temporarily exceed 55% of GDP, rating agencies did not make any changes to Malaysia's sovereign debt ratings, at least for now.
- ✓ Taking into account the impact of pandemic-induced slowdown on government finance, Fitch Ratings revised the rating outlook to negative while maintain the existing rating at A-. Similarly, S&P Global Ratings also made the same move, affirming long-term credit rating at A- and revising the rating outlook to negative in view of downside risk to government's finance.
- ✓ The unchanged ratings reflect continued confidence in the government's fiscal management, without ruling out the possible downside risk from the increased pressure on government finance from the ongoing coronavirus pandemic.
- ✓ Therefore, the downside risk or the volatility of the Ringgit could be contained barring any circumstances from the political front.

IMPACT – GOVERNMENT BOND YIELDS

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- ✓ As more govvies are expected to be issued in 2021, the yields in government bonds will increase.
- ✓ The reason being is that the higher issuances would mean more supply of bonds which would exert downward pressure on bond prices and subsequently push yields above.
- ✓ Based on historical data, the 3-Y, 5-Y, and 10-Y MGS yields were higher in some years when there was a sharp increase in govvies issuances. From 2000 to 2019, there were six years in which 10-Y MGS yields recorded an annual positive change following the increase in supply of government bonds in the market.
- ✓ The year 2009 saw the highest increase in issuance of govvies at 47.0% year-on-year (y-o-y). As such, 3-Y, 5-Y, and 10-Y MGS yields were all higher by 29.6, 83.3 and 108.5 bps, respectively. This reflected the post Global Financial Crisis 2008 period where the government needed funds to spur economic growth. Henceforth, the similar scenario is likely to repeat as 2021 will be the year of economic recovery.

Annual change in 3-Y, 5-Y, and 10-Y MGS Yields in relation to Govvies Issuance and Fiscal Deficit

Year	Annual Change in Yields (Basis Points)			Govvies Issuance (RM Billion)	Fiscal Deficit (RM Billion)
	3-Y MGS	5-Y MGS	10-Y MGS		
2000	-35.5	-96.1	-87.0	18.4	-19.7
2001	-78.5	-106.9	-173.5	24.9	-18.4
2002	-2.8	0.0	6.5	19.0	-20.3
2003	77.8	119.4	88.0	43.0	-20.9
2004	-76.0	-71.0	3.0	46.6	-19.4
2005	54.7	8.5	-54.1	32.3	-18.7
2006	6.9	0.9	-41.9	36.3	-19.1
2007	-0.5	8.1	36.1	53.2	-20.7
2008	-67.3	-82.9	-96.4	61.1	-35.6
2009	29.6	83.3	108.5	89.8	-47.4
2010	-13.1	-45.5	-25.0	58.7	-43.3
2011	-13.1	-11.6	-31.2	91.8	-42.5
2012	0.9	0.2	-21.1	94.7	-42.0
2013	35.9	45.3	63.2	92.5	-38.6
2014	28.2	14.7	-3.2	85.3	-37.4
2015	-34.0	-37.3	9.0	92.4	-37.2
2016	27.4	26.9	4.8	87.4	-38.4
2017	-24.5	-19.0	-31.2	107.4	-40.3
2018	30.2	22.5	16.5	113.3	-53.4
2019	-62.4	-60.4	-77.4	118.6	-51.5
2020E	-88.9	-73.2	-48.6	142.8	-103.0
2021F	33.0	21.0	29.0	153.6	-100.4

Sources: Bloomberg, Ministry of Finance, Bank Islam

IMPACT – GOVERNMENT BOND YIELDS

- ✓ The higher issuances expected in 2021 serves as an additional ground for government bond yields to rise moving forwards.
- ✓ This is because the equity market expected to improve (seen through higher expected earnings per share (EPS) of the FBM KLCI). Henceforth, there is a high likelihood that investors may allocate more weightage in the equity market compared to safe haven assets. As a result, bond yields may start to increase again and limit the upside of bond prices for bond holders.
- ✓ On further scrutiny, the 3-Y MGS yields have been on the downtrend on a year to date basis. So the possibility for yields to spike is always there given the aforementioned circumstances.

Earnings Growth Trajectory of the FBM KLCI

Year	Earnings Per Share (EPS) of FBM KLCI	Year-on-year (y-o-y) EPS Growth
2021F	93.1	8.1%
2020E	86.1	-3.8%
2019	89.6	12.9%
2018	79.3	-26.5%
2017	107.9	9.8%
2016	98.3	4.4%
2015	94.2	-13.0%

Sources: Bloomberg

Year-to-date 3-Y MGS Yields (%)

Sources: Bloomberg

IMPACT – GOVERNMENT BOND YIELDS

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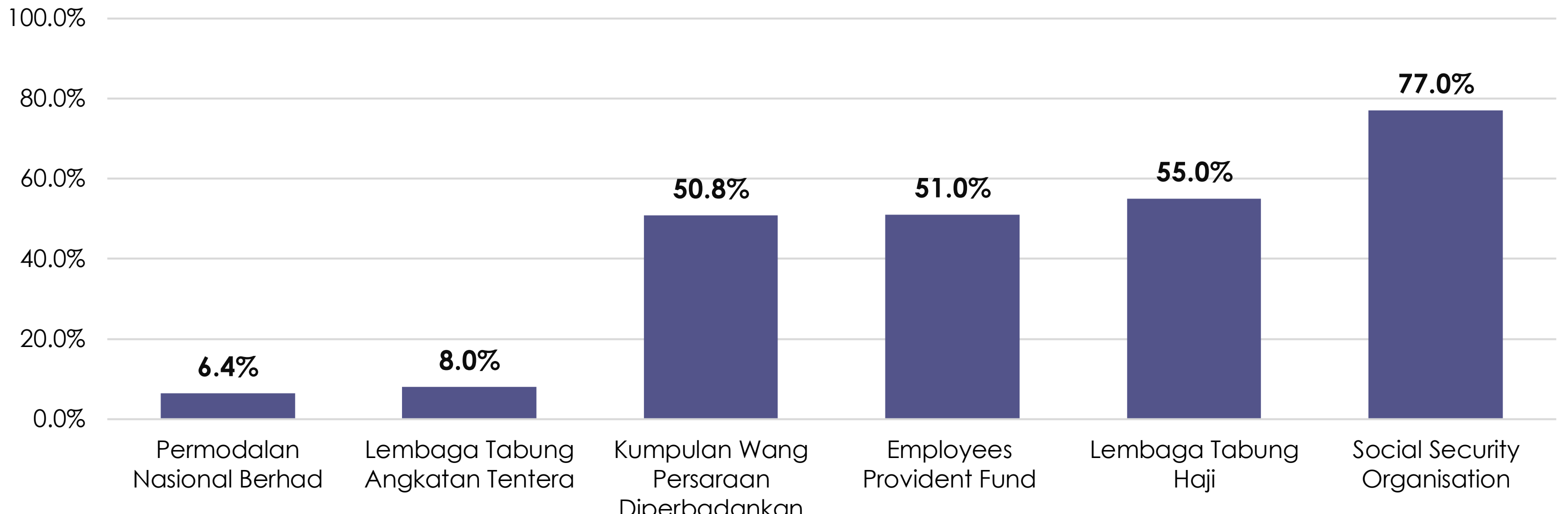
- ✓ It is also worthwhile noting that a high issuance of govvies could be absorbed by local institutional funds.
- ✓ In general, assets under management of most local institutional funds have a relatively high exposure to the fixed income market.
- ✓ Nevertheless, there are some funds such as Permodalan Nasional Berhad which only has a 6.4% exposure to fixed income securities out of its asset under management.
- ✓ Other notable institutions include Lembaga Tabung Angkatan Tentera has only 8.0% of its total assets allocated to the fixed income market.
- ✓ Therefore the capacity for these institutions to subscribe to the higher issuances of govvies is there.

Percentage of Assets Allocated Under Fixed Income for Local Institutional Funds as of their latest available annual report



Sources: Local Institutional Funds

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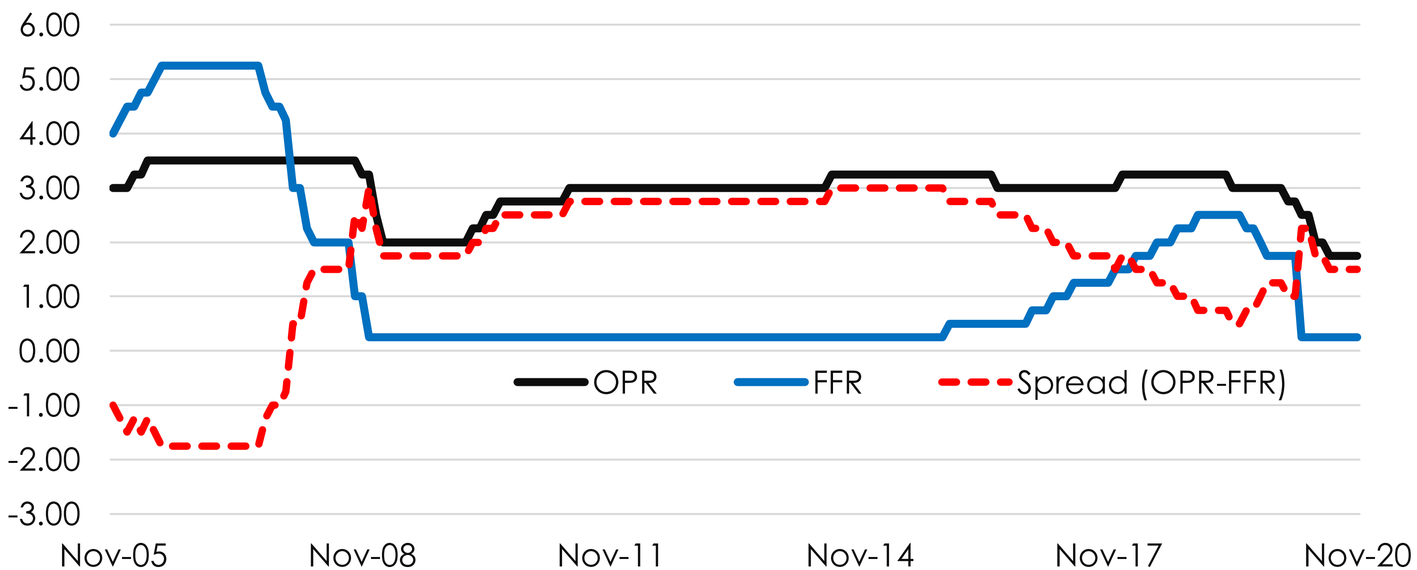
- ✓ Fiscal measures expecting to play a stronger part in the heavy lifting of the economy.
- ✓ Therefore, the OPR is expected to remain at the current level of 1.75%.
- ✓ As of late, Malaysia's OPR spread against the FFR stood at 150 bps (1.75% minus 0.25%). This would mean the BNM still has some policy space to ease the monetary policy from the interest rate differentials point of view.
- ✓ Moreover, the central bank would want to conserve its ammo in the event of any adversaries (downside risks to the outlook).

Overnight Policy Rate (OPR) vs. Federal Fund Rate (FFR)



Sources: Bloomberg

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THANK YOU

Bank Islam ensures that social and environmental considerations are consistently its top priority governed by the Bank's core values and Shariah principles. More initiatives will be developed by the Bank as the Bank strives to make a positive difference for its financial and social performance.