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BUDGET 2024: BALANCING GROWTH AND FISCAL SUSTAINABILITY

	Revised Budget 2023	Budget 2024	
	2023	2023	2024
Real GDP (% y-o-y)	~4.5	~4.0	4.0-5.0
Fiscal Balance (% of GDP)	-5.0	-5.0	-4.3
Estimated Revenue (RM billion)	291.5	303.2	307.6
Tax Revenue (RM billion)	218.3	229.0	243.6
Indirect Tax Revenue (RM billion)	54.1	56.0	58.6
Non-tax Revenue (RM billion)	73.2	74.2	a64.0
Revenue (% of GDP)	15.4	16.4	15.6
Total Expenditure (RM billion)	386.1	397.1	393.8
Operating Expenditure (RM billion)	289.1	300.1	303.8
Development Expenditure (RM billion)	97.0	97.0	90.0
Total Expenditure (% of GDP)	20.4	21.5	19.9
Debt (% of GDP)	62.0	62.0	64.0

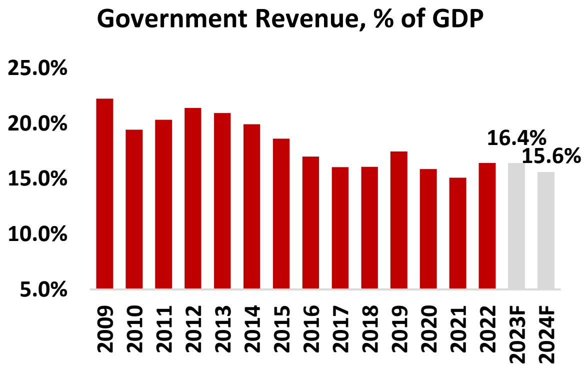
Sources: Ministry of Finance (MoF), Bank Islam

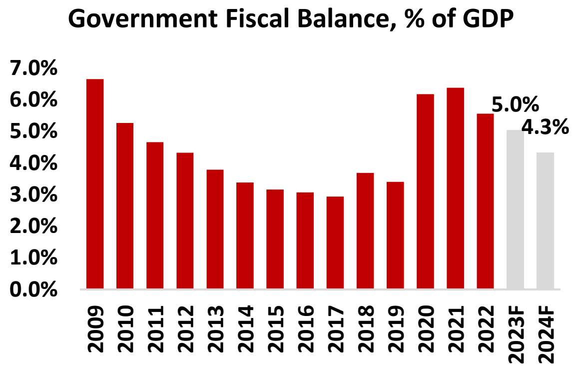
- **The Budget 2024 tabled by Prime Minister-cum-Finance Minister Y.A.B. Datuk Seri Anwar Ibrahim on October 13, 2023, while reaffirming commitment to fiscal consolidation, remains slightly expansionary with a record allocation of RM393.8 billion (revised Budget 2023: RM386.1 billion).** Of this, operating expenditure (OPEX) is projected to come in higher at RM303.8 billion relative to 2023's revised estimate of RM300.1 billion (original estimate: RM289.1 billion). Meanwhile, there is a reduction in development expenditure (DEPEX) to RM90.0 billion (2023 estimate: RM97.0 billion). Overall, the increase in allocation size over the previous budget seems smaller for Budget 2024.

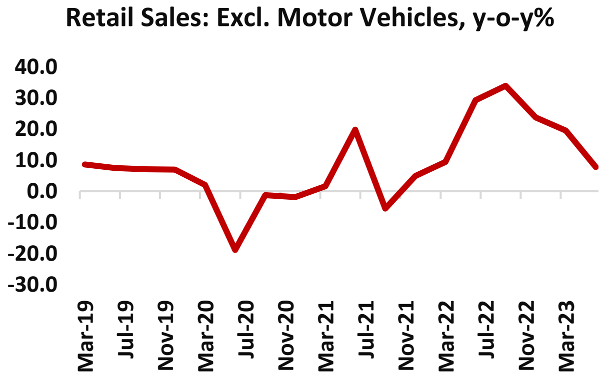
- **The proposed slightly higher allocation is not a surprise** given the government's pledge to, among other goals, promote sustainable economic growth, increase household income and enhance social welfare as indicated in the 12th Malaysia Plan (MP) Mid-Term Review (MTR). The government has earlier raised the total allocation for the 12MP to RM415.0 billion from RM400.0 billion allocated in 2021.

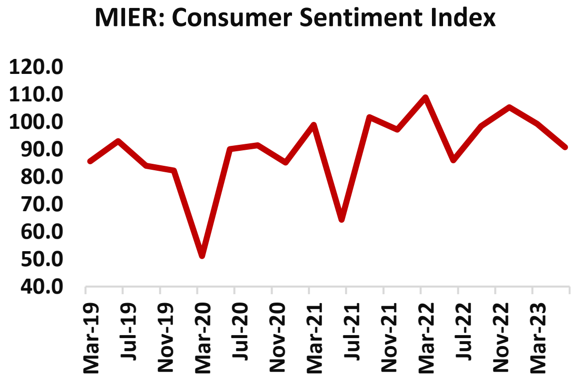
- **A faster decline in fiscal deficit is envisaged in the Budget 2024**, to 4.3% of GDP in 2024 from the government's forecast of 5.0% in 2023. The move aligns with the government's mid-term stated goal of consolidating fiscal deficit to an average of 3.5% in the 2024-2026 period. The government plans to achieve these via a combination of spending rationalisation and revenue mobilisation, which is nevertheless dependent on a continued robust macroeconomic performance.

- **The government projects the real GDP growth to reach between 4.0% and 5.0% in 2024, which aligns with our current forecast of 5.0%.** However, our forecast remains subject to risks of a protracted and significant slowdown in major trading partners and geopolitical tensions. We also expect slightly lower real GDP growth at 3.7% in 2023, compared to the government's projection of "around 4.0%". Meanwhile, the government's inflation forecast comes in higher at the range between 2.1% to 3.6% in 2024 (2023 forecast: 2.5% – 3.1%), which likely has taken into account the potential impacts of price shock arising from the phased cut in diesel subsidies and the removal of the temporary ceiling price imposed on chicken and eggs.









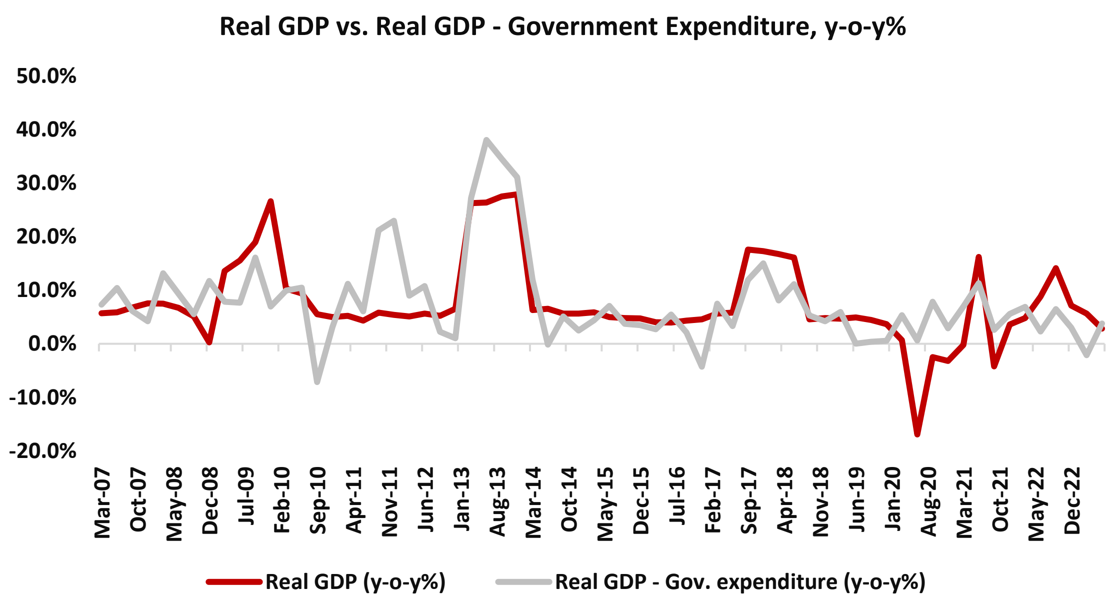
Sources: MoF, Department of Statistics Malaysia (DoSM), Bank Islam

- **As the economy continues to show resilience, the government revenue estimate for 2023 is revised upward** to RM303.2 billion from the initial estimate of RM291.5 billion (2022: RM294.4 billion). The government expects higher tax revenue collection (2023 estimate: RM229.0 billion vs. 2022: 208.8 billion), mainly from the Companies' income tax (CITA) (2023 estimate: RM98.4 billion vs. 2022: RM82.1 billion) and personal income tax (2023 estimate: RM39.7 billion vs. 2022: RM33.8 billion). However, this would be partly offset by the lower receipts from petroleum income tax (PITA) (2023 estimate: RM20.5 billion vs. 2022: RM23.4 billion) amid the moderation in global crude oil prices.

- **Reducing reliance on petroleum-related revenue.** We concur with the government's stance to cut oil revenue dependence amid the depleting oil resources, estimated to last around 14 years at the current consumption level. Furthermore, Malaysia's economy has long depended on energy exports. A global oil shock will, in turn, lead to a drop in national output and derail the fiscal outlook. Despite a slightly higher oil price assumption of USD85 per barrel, which aligns with our forecast, the government expects the share of oil-related revenues to fall to 20.1% of total revenue in 2024 (2023 estimate: 23.0%).

- **Broadening the tax base – Goals drive impact.** One of the laudable strategies the government has announced is its efforts to broaden the tax base, aiming to minimize tax leakages, foster inclusiveness and facilitate a more efficient income redistribution. In contrast, we opine that the most crucial drive is the declining trend of revenue-to-GDP. As it is, Malaysia's revenue-to-GDP is set to come in as one of the lowest in ASEAN, with the assumption of revenue slipping to 15.6% of GDP in 2024 (2023 estimate: 16.4%). While we concede that empowering the people and ensuring that revenues are redistributed evenly are just causes, concerns arise from revenue sustainability.

- **The *Now* that matters.** The Budget had introduced various tax measures, including an increase of the service tax rate from 6% to 8%, excluding certain services, and expanding the scope of taxable services. We would suggest that their impact towards overall revenue is insignificant. Despite the higher service tax and widened scope, SST revenues are projected to edge up to RM35.8 billion or 11.6% of total revenue in 2024 (2023: RM34.2 billion or 11.3% of total revenue). Implementing the announced initiatives on a narrow tax base could not boost our sluggish revenue growth. Considering that an extended period is required from the announcement of new taxes to the commencement of said taxes, the government must act now to achieve stable long-term results. It is urgent for the government to amplify their efforts and to solidify their plans to expand the tax base.

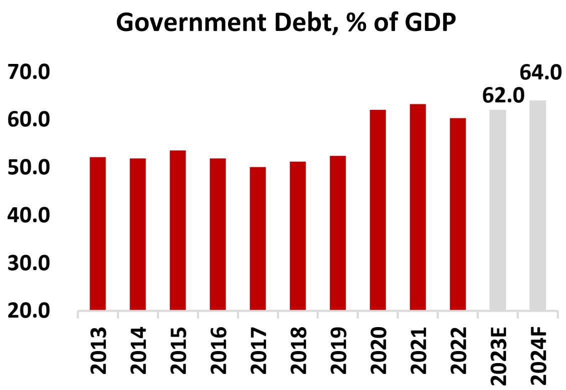


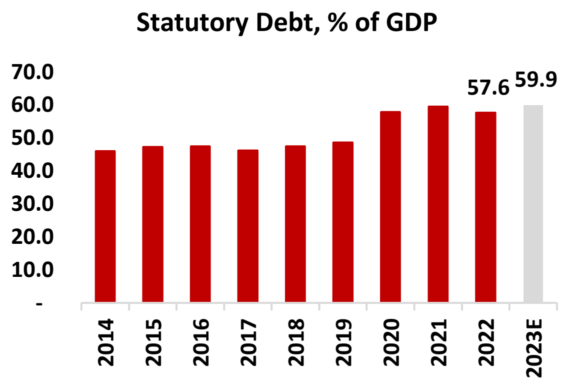
Sources: DoSM, Bank Islam

- **Addressing fiscal risks.** We posit that the government may have to spend more than expected in 2024 as slowing growth looms over the economy. We do not rule out the possibility of an economic downturn in the latter half of 2024 amid a declining trend in private expenditure, which had been the major engine for growth. We already see signs of moderating spending amid falling consumer confidence (2Q2023: 90.8 points vs. 1Q2023: 99.2 points) and easing retail sales (2Q2023: 7.8% vs. 1Q2023: 19.5%). In addition to the sluggish demand, the ongoing cost of living crisis and a possible food crisis could pressure spending, especially in a stagnating wage growth environment. Of note, the Budget saw the government's plans to float chicken and egg prices, which will be unveiled by the Agriculture Ministry soon. Externally, the escalation of conflict in the Middle East will disrupt the global supply chain, resulting in higher oil prices and, thus, exacerbating inflationary pressures. All these scenarios point to consumers shifting their spending patterns and saving more.

- **Given the rigid expenditure profile, the government will likely face challenges in rationalising expenditure**, with emoluments, retirement charges, and debt service charges accounting for over one-half of total OPEX. In addition, the likely gradual pace of subsidy rationalisation or restructuring, while providing some relief with the retention of most food and fuel subsidies, implies limited cost savings.

- **Utilising fiscal policy as a buffer.** In the wake of dampening domestic demand, the government would have to intervene and shelve their plans for subsidy rationalisation for another day. Instead, they would have to deliver necessary stimulus measures to support the economy as 1) an economic downturn would narrow the fiscal space, underpinned by smaller revenue growth, and 2) dissipating fiscal space, for an extended period, would complicate the deliverance of such measures. Due to its countercyclical nature, fiscal policy is often used to smooth out business cycles and cushion major downside pressures on growth. The chart above shows that past recessions would be steeper without government support. Therefore, we believe that the government should consider spending more should the economy slow further.

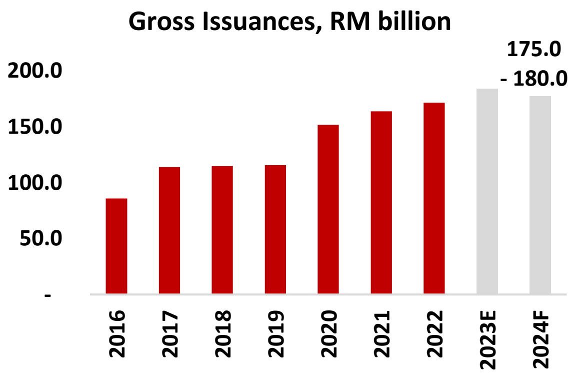


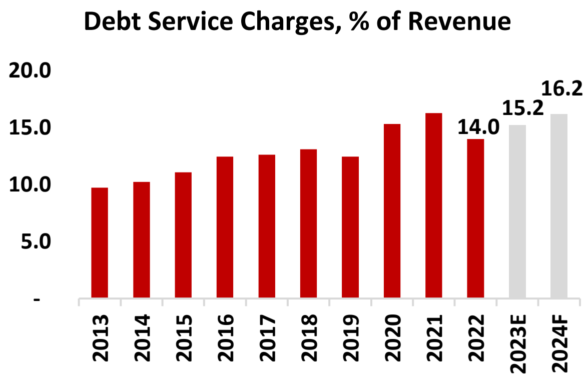


Sources: MoF, Bank Islam

- **Debt level to remain elevated in 2024 with statutory debt nearing the 65.0% limit.** In Budget 2024, total federal government debts are expected to uptrend to 64.0% of GDP in 2024, higher relative to 62.0% in 2023. As of the end of 2022, total federal government debt stood at 60.3% of GDP. Meanwhile, the statutory debt, which comprises Malaysian Government Securities (MGS), Government Investment Issues (GII) and Malaysian Islamic Treasury Bills (MITB), logged 59.9% of GDP as of end-August 2023. Albeit the amount is lower than the current statutory debt limit of 65.0%, it denotes that the government has very limited room in utilising the debt space to finance infrastructure projects and medium to short-term government development plans. Further improvements in the domestic investment landscape is paramount in addressing this issue.

- **Infrastructure projects to inch up debt and liabilities exposure.** Debt and liabilities exposures consist of Federal Government debt, committed guarantees and other liabilities, namely financial commitment from public-private-partnership (PPP) and private finance initiatives (PFI) projects. Total debt and liabilities exposures were 81.6% of GDP as of end-June 2023 (2022: 80.7%). During the tabling, the latest announcement on the infrastructure project was on the Penang Light Rail Transit (LRT), which amounted to RM10.0 billion; although commendable, it would be financed via PPP. Government financing via contingent liability should come in lower than 25% of GDP following the passing of the Fiscal Responsibility Act last week. Per stress tests conducted by the MoF, the crystallisation of contingent liabilities could see total federal government debt hitting 82.8% of GDP in 2024.





Sources: MoF, Bank Islam

- **We foresee government bond issuances in the range of RM175 billion to RM180 billion in 2024.** The figures are based on the upcoming maturities totalling RM93.0 billion and the government's projected fiscal deficit of RM85.4 billion in the Budget 2024 tabling. As of the first eight months of 2023, the government has issued MGS and GII amounted to RM129.5 billion and expects a total MGS and GII issuances of RM186.0 billion in 2023. The government issued two sustainability GII bonds in 2022 and 2023 totalling RM10.0 billion, which garnered robust demand with oversubscription by more than two times. Additionally, the government intends to issue sustainable MGS and GII via Bank Negara Malaysia (BNM) as part of the annual auction calendar to finance action plans in the New Industrial Master Plan 2023 (NIMP 2030).

- **Debt affordability to pose a challenge.** The government foresees that the debt service charges (DSC) will hover at 16.2% of revenue in 2024 (2023: 15.2%), higher than the administrative limit of 15.0% of revenue amid a lower fiscal deficit. With the limited revenue space, debt affordability would be a challenge given the high interest rates environment globally. Nevertheless, foreign exchange risks remained relatively low given that its foreign currency-denominated debt stood at 2.7% of total debt outstanding as of 2Q2023 (2022: 2.7%). Thus, lowering foreign exchange vulnerabilities despite the increasing cost of debts, given the higher-for-longer interest rate rhetoric by major central banks.