NATIONAL BUDGET 2023 PREVIEW

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FIRDAOS ROSLI
NOR JANNAH ABDULLAH
RAJA ADIBAH RAJA HASNAN

Section 1

The importance of Budget 2023

BUDGET 2023: WEATHERING THE STORM AMID HEIGHTENED FISCAL PRESSURE

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- **Budget 2023 will be expansionary –** The national budget for 2023 will be tabled on 7 October. We expect Budget 2023's total budget allocation to come in higher between 2.0-2.5% than in 2022. Against this backdrop, the fiscal deficit would be lower at circa 5.8-6.0%, with GDP growth in the range of 4.0-5.0%. Inflation remains manageable at 2.1%, while unemployment trends at around 3.5%.

- **Budget 2023 is the final national budget cycle in the present political cycle.** The ruling coalition had announced that GE15 would be called by this year. Considering the parliament will automatically dissolve in mid-July 2023, Budget 2023 will endure greater public scrutiny as it is the final budget in the present mandate.

- **Growth headwinds abound in 2023** – All multilateral development banks are projecting that global growth will moderate in 2023 amid the strong US Dollar environment, elevated commodity prices, and supply-side constraints. Although Asia, in particular Southeast Asia, is expected not to suffer as badly as advanced economies would in the coming next year, the government is wary about the contagion effect on the Malaysian economy. Hence, we expect the government to offer rakyat-centric incentives for the labour market to recover gracefully in the post-pandemic era.

- **It sits in the middle of the 12th Malaysia Plan (12MP)** – While keeping the fiscal constraints and growth headwinds in check, the government is likely to realign the present economic trajectory on track with the 12MP targets. Thus, we expect reforms in the pipeline. Since the 12th Malaysian Plan (12MP) mid-term review report will be unveiled in a year, Budget 2023 should recalibrate policies towards the sustainability agenda, particularly in climate change and bridging the development gaps between states and regions, inter- and intra-racial divides as well.

BUDGET 2023

FOCAL PRIORITIES

1 Rakyat

2 Business

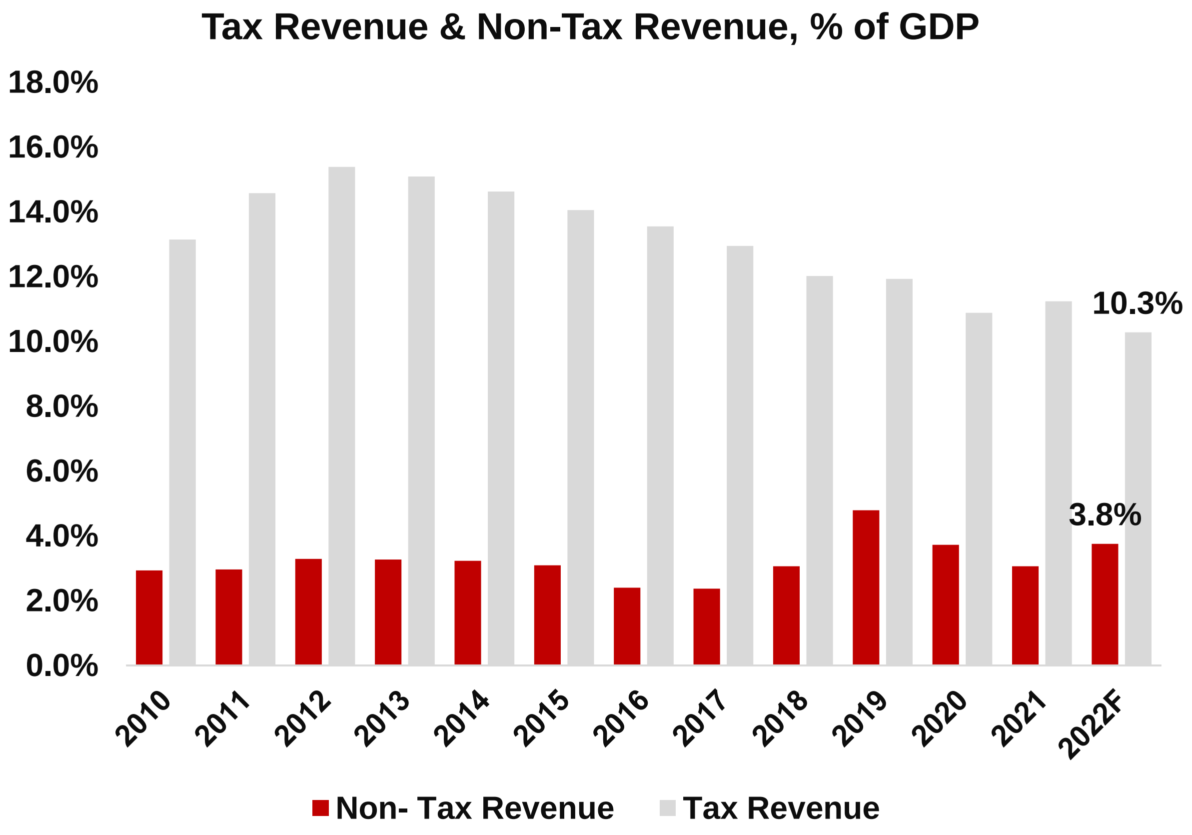
3 Economy

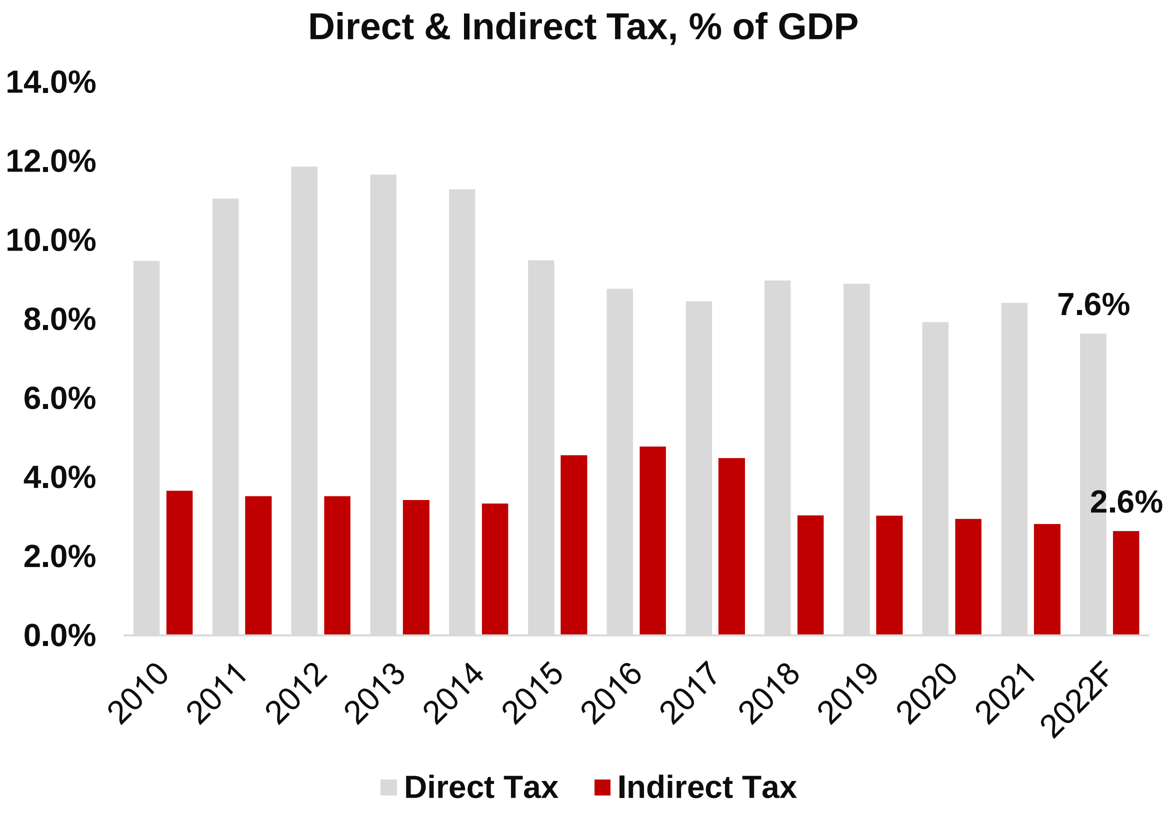
4 Government

Section 2

Reduce fiscal pressure

1. EFFORTS TO REDUCE FISCAL PRESSURE





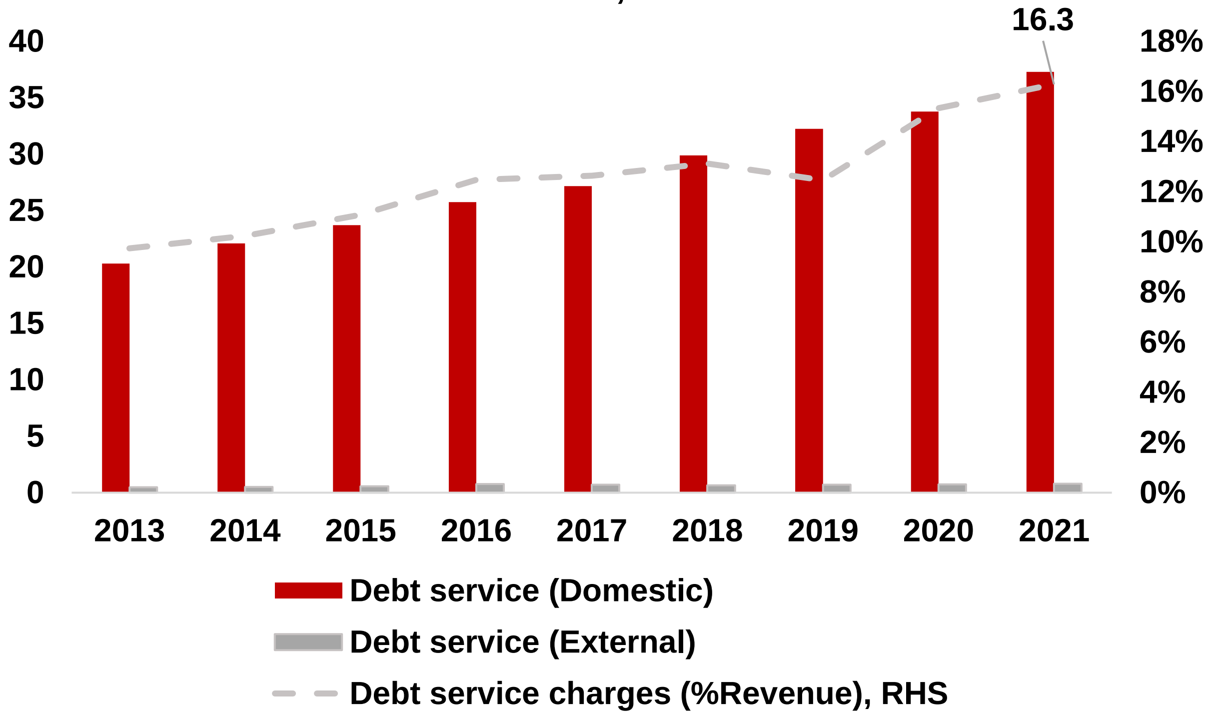
Sources: CEIC, MOF, Bank Islam

- Tax revenue-to-GDP has been declining since 2012.
- Although post-GFC fiscal consolidation efforts successfully reduced the reliance on non-tax revenue, it has been trending higher since 2018. In turn, Malaysia is now more susceptible to changes in global oil prices.
- We would like to see efforts in addressing its tax buoyancy.

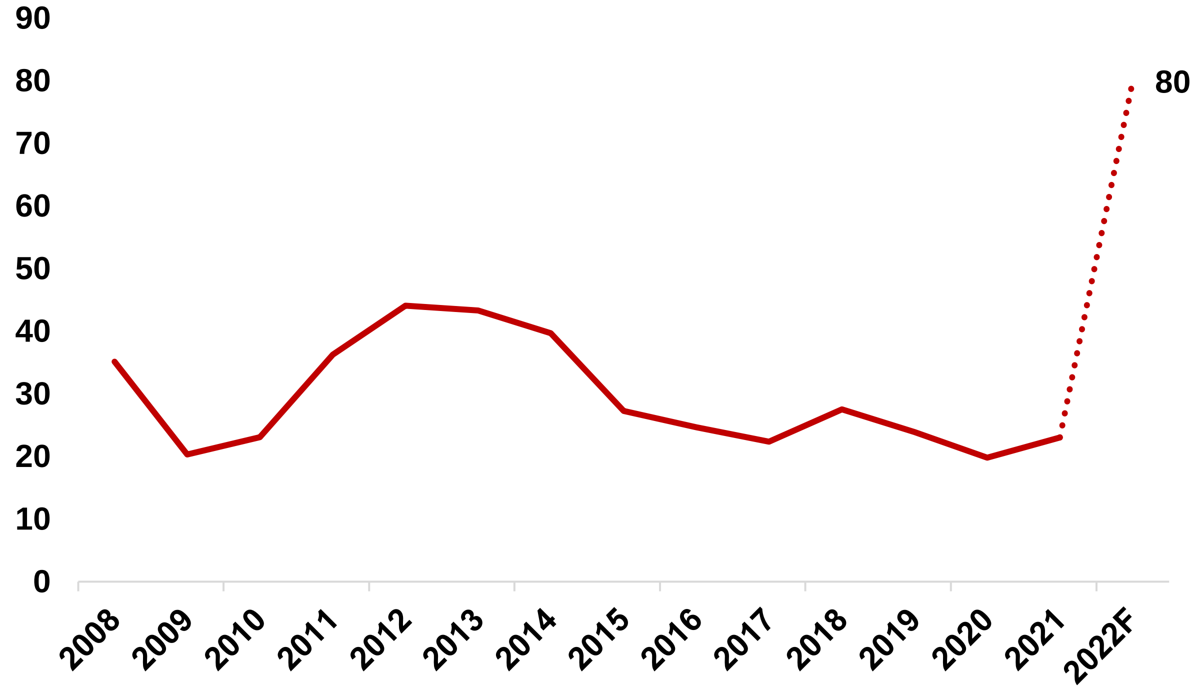
- The Goods and Services Tax (GST) repeal disrupted efforts to shift the tax incidence from direct to indirect tax.
- The government needs a more stable tax system as the economy grows.
- We expect the government to bring us closer to the reintroduction of GST.

1. EFFORTS TO REDUCE FISCAL PRESSURE

Debt service, RM Billion



Expenditure: Subsidies, RM Billion



Sources: CEIC, MOF, Bank Islam

- On the expenditure side, the hot-button issue lies in debt service charges and subsidies. Pandemic-induced spending pushed the debt ceiling twice since 2020. As a result, the debt service has breached the 15% administrative level in 2021.
- External debt service remains very low amid a low level of foreign currency borrowings. In mitigating this issue, we believe that the government should improve the revenue side of the budget.

- We anticipate that the government's move to boost subsidies amid growth headwinds is justified. Higher subsidies keep inflation in check while economic and border reopening allows economic activities to return to their pre-pandemic levels gradually.
- As fuel takes the largest percentage of subsidies, we expect the government to rationalise subsidies by introducing a targeted fuel subsidy system or returning to the monthly/weekly retail pricing of petroleum products.

1. EFFORTS TO REDUCE FISCAL PRESSURE

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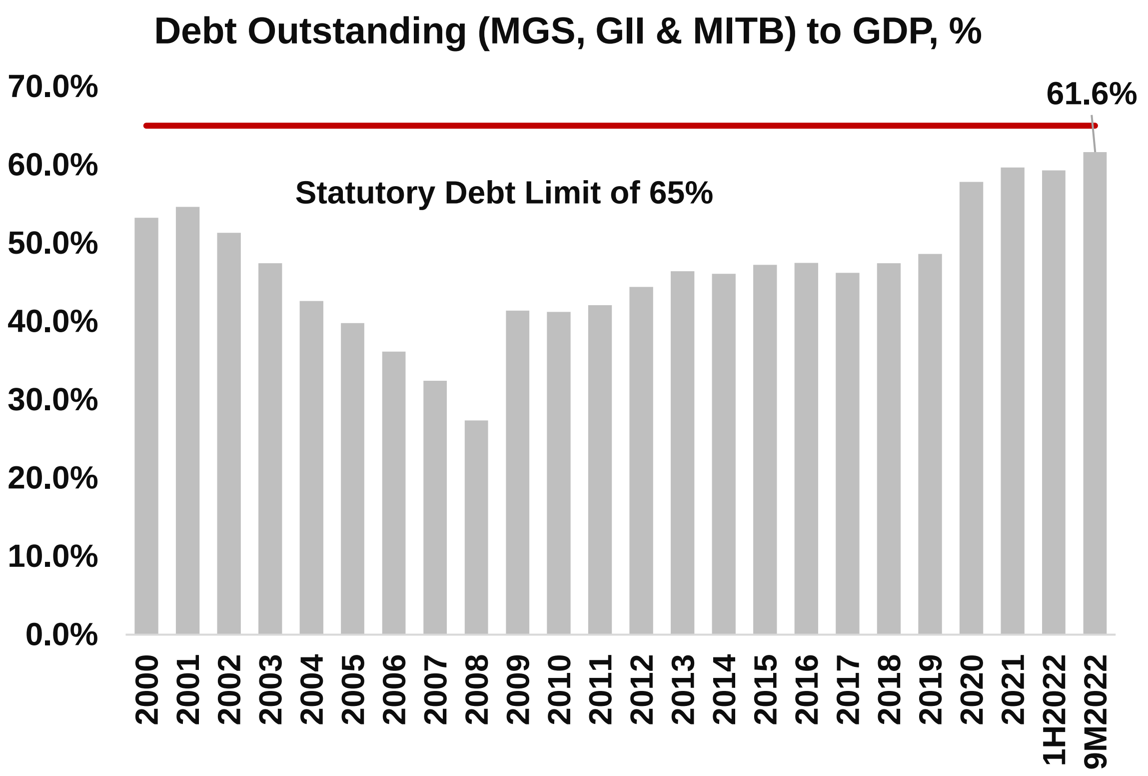

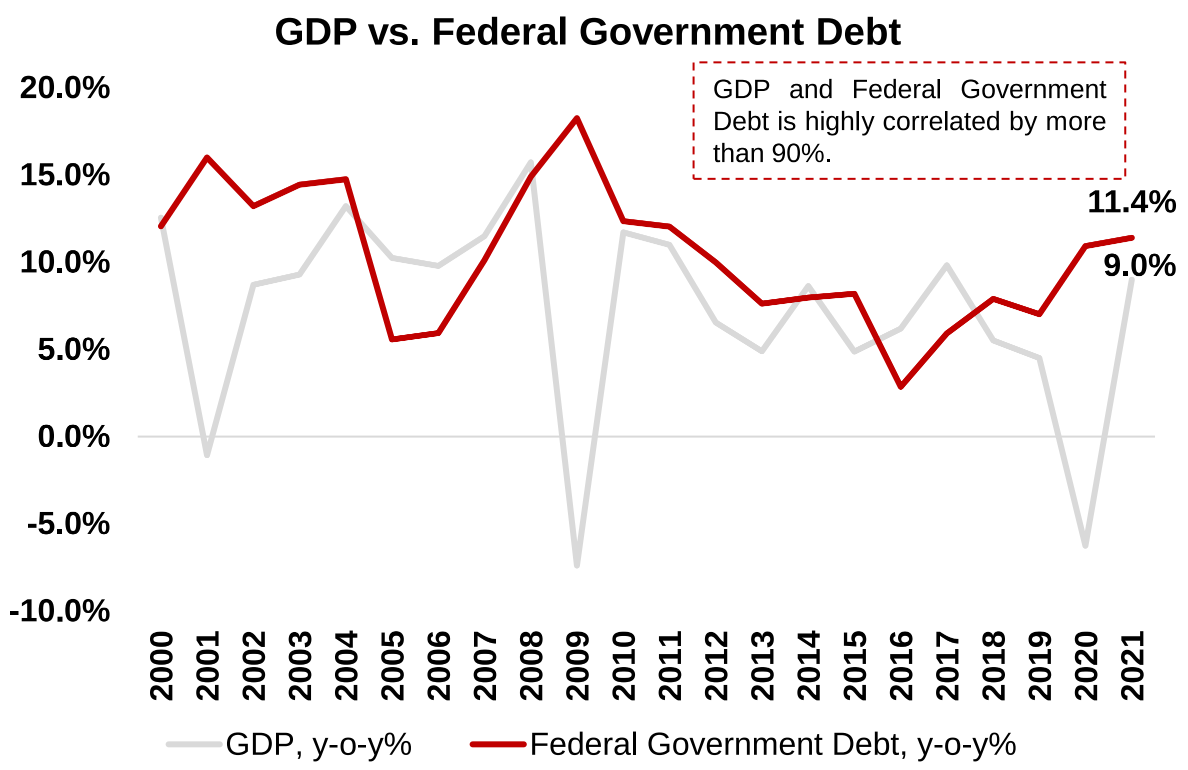

Sources: CEIC, BNM, Bank Islam

- Pandemic-induced spending continues amid an anaemic labour market. As of 1H2022, we believe that the statutory debt-to-GDP is reaching 65% ceiling.
- We expect the statutory debt ceiling to remain as is, as the latest economic indicators are pointing towards solid GDP growth in 2022.
- As growth headwinds abound in 2023, we expect the government to outline a clearer picture of turbo-boosting growth in the coming year.
- Immediate GDP-enhancing effort is key in keeping the debt-to-GDP ratio within the current statutory limit of 65%.

REDUCING FISCAL PRESSURE IS PARAMOUNT AS MALAYSIA APPEARS WEAKER THAN ITS RATED PEERS

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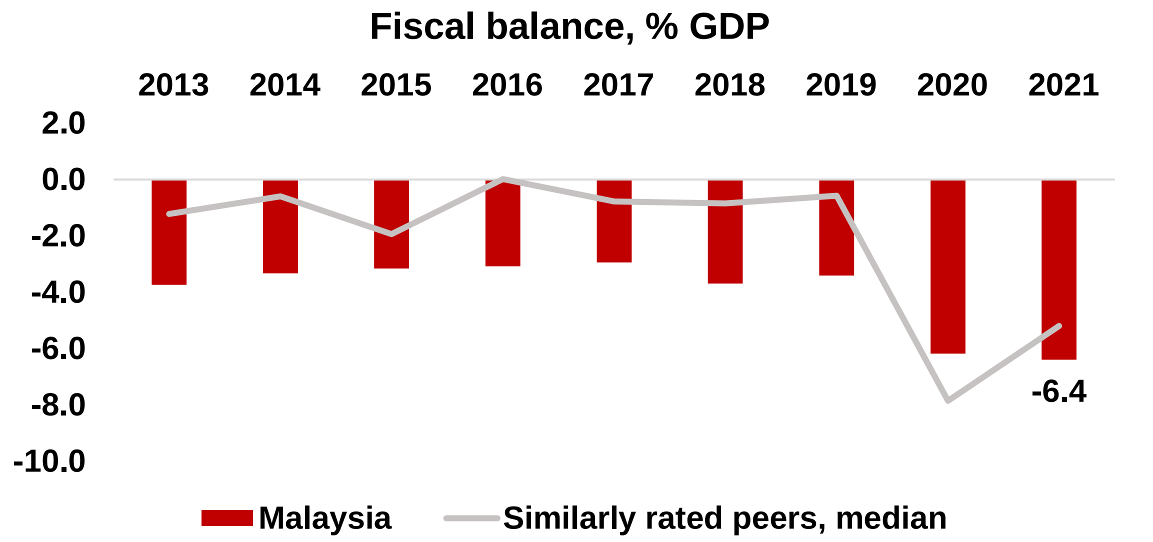

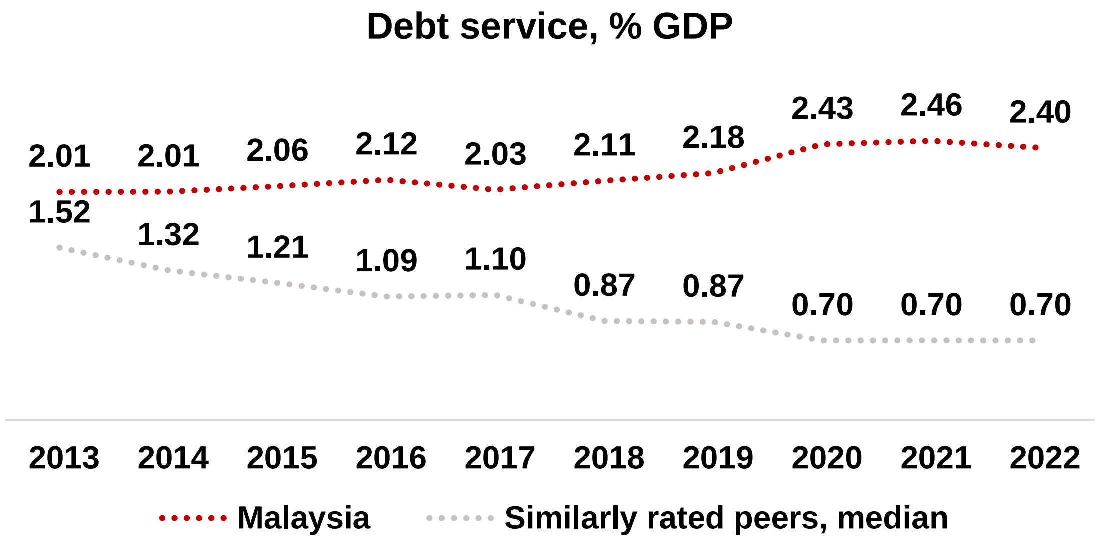

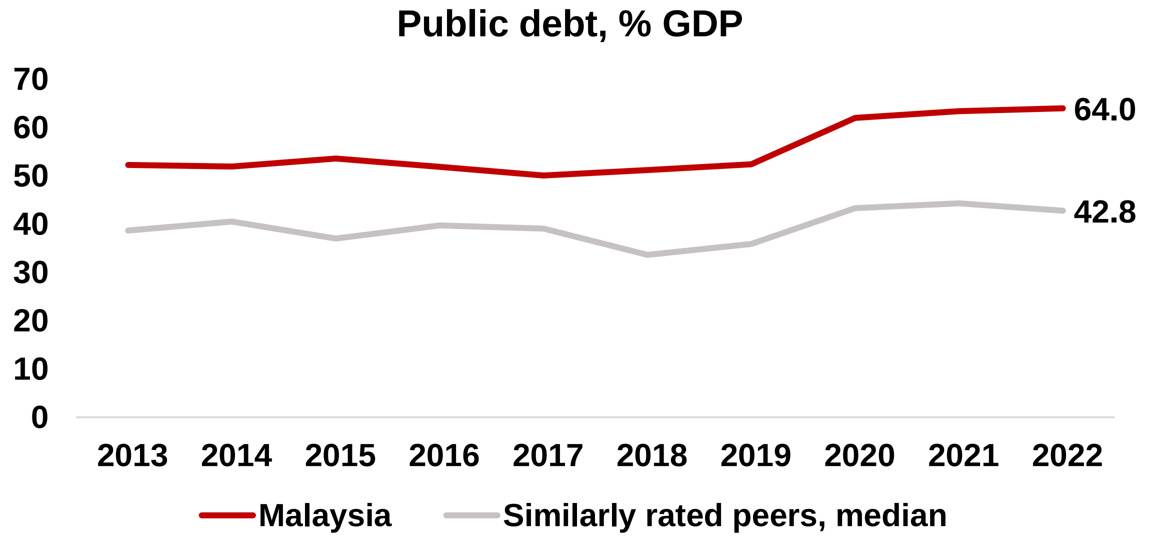

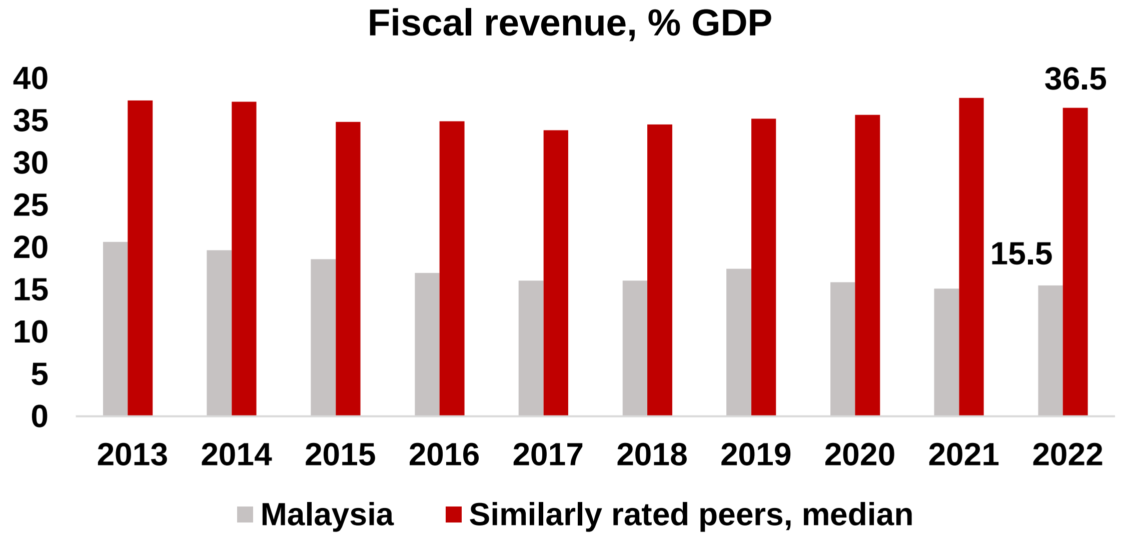

Sources: EIU, Bank Islam

Similarly rated peers: Botswana, Latvia, Lithuania, Peru and Slovenia

Section 2

Revitalise the labour market

WAGE GROWTH IS KEY TOWARDS ATTAINING THE HIGH-INCOME NATION STATUS

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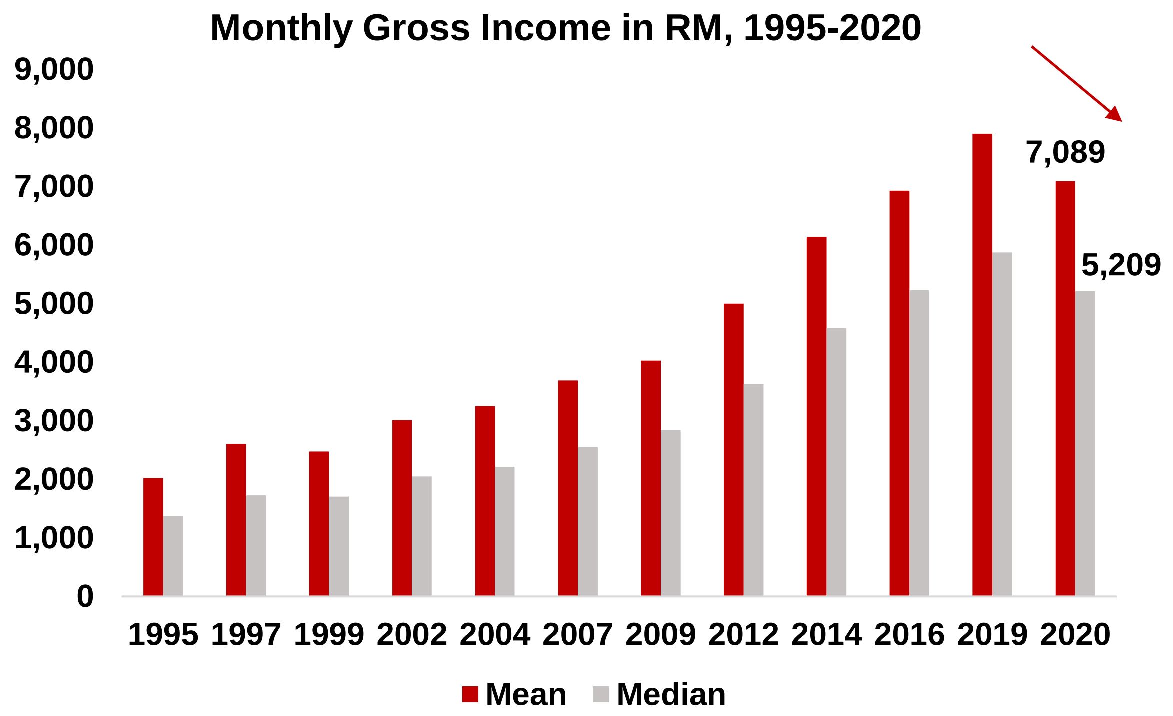

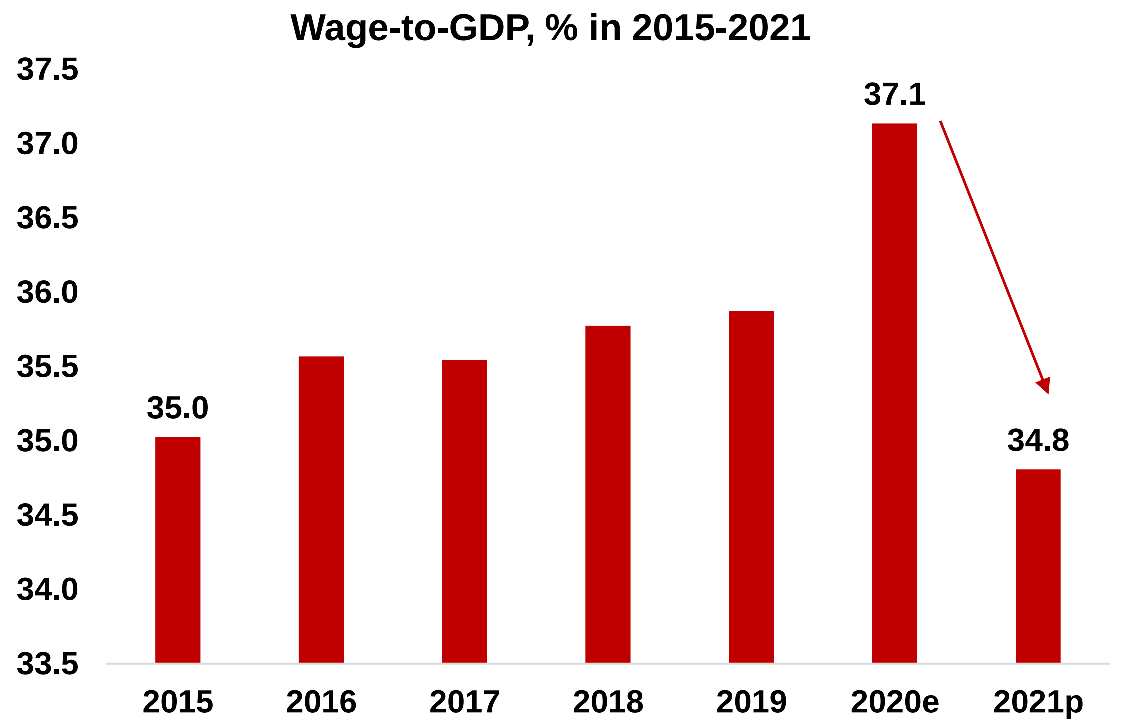

Sources: DOSM, Bank Islam

- We welcome the government's on-going Income, Expenditure and Basic Facilities 2022 survey, which will be unveiled in 1Q2023. In line with the declining unemployment rate (Jan 2022: 4.2%, July 2022: 3.7%), we believe that household incomes will go up eventually, albeit below the pre-pandemic levels.
- As such, we believe that the government will introduce new initiatives to improve the rakyat's disposable income and enhance the social protection programme.

- The 12th Malaysia Plan aims to bring Malaysia's wage-to-GDP ratio to 40% by 2025. Regrettably, the target seems ambitious amid prolonged lockdowns, bringing the ratio down from 37.1% in 2020 to 34.8% in 2021.
- Therefore, we expect the government to outline policies to repair the labour market through upskilling and reskilling programmes, digitalisation and another revision of the minimum wage.

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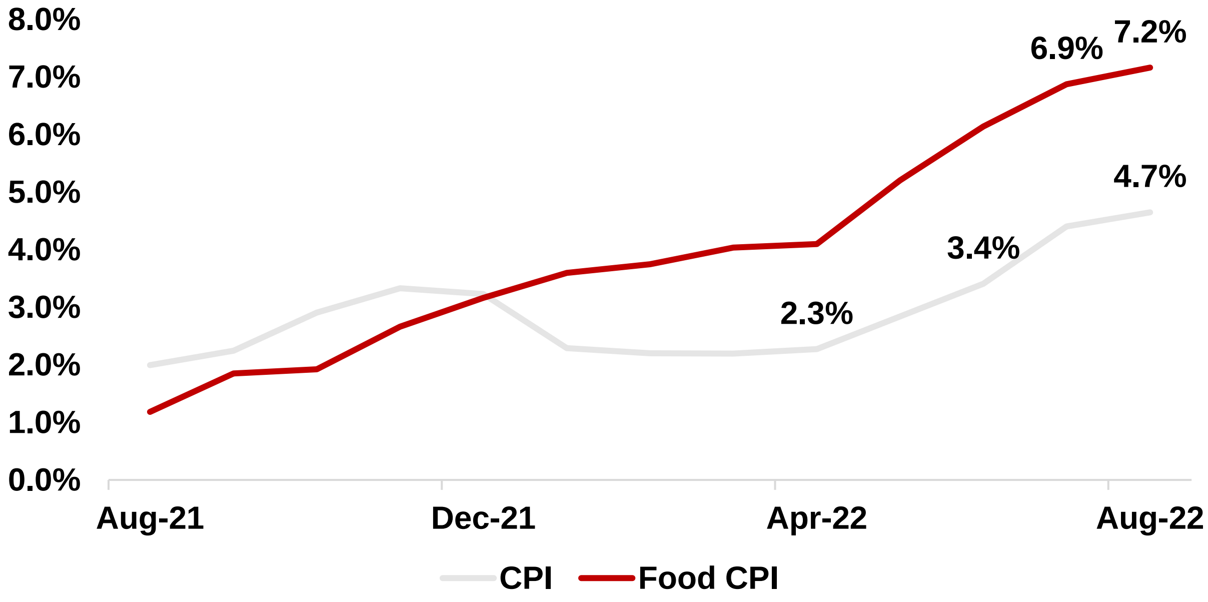

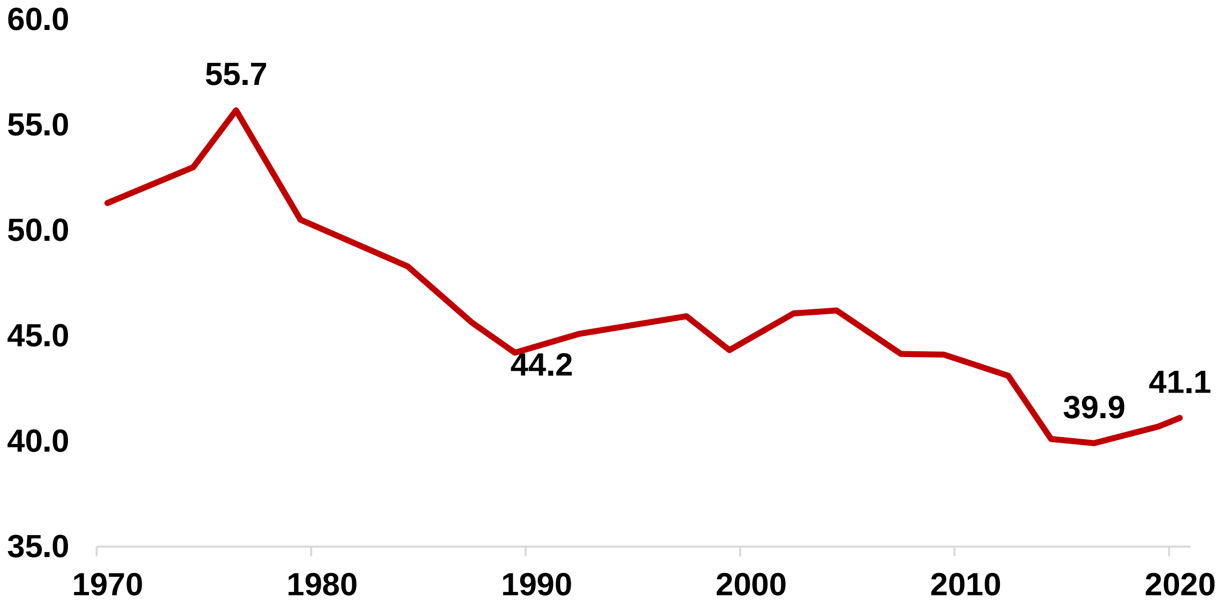

Sources: DOSM, Bank Islam

- We believe that inflation will peak in 4Q2022. However, rising prices will persist amid unfavourable USD/MYR exchange rates and supply-side constraints. As such, we take it that the government will continue the current subsidies and price control mechanism on basic goods and services.
- Should the Automatic Pricing Mechanism (APM) system be reintroduced, the government will rebalance this policy by enhancing the existing income supplement system to cushion rising prices.

- Income and wealth inequalities worsened amid prolonged lockdowns, leaving the vulnerable groups more exposed to rising inflation.
- One way to address this is by bridging the development gap between states and regions. We believe that the government will outline a more comprehensive account of digitalisation via 5G, infrastructure development and improvements to access to finance and social welfare.

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