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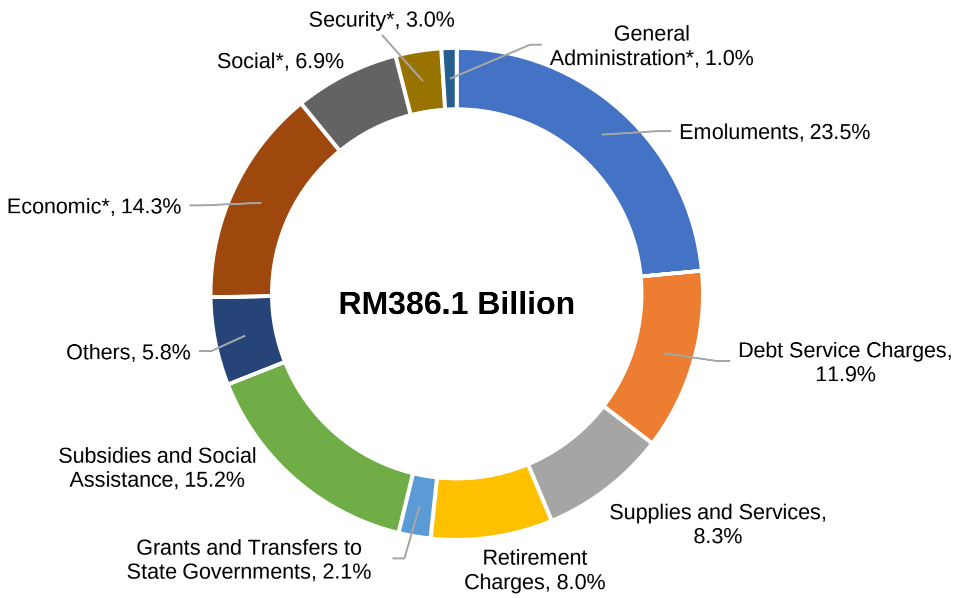
REVISED BUDGET 2023: *MEMBANGUN MALAYSIA MADANI*

PART ONE: OUR OVERALL TAKE ON THE REVISED BUDGET 2023

- On 24 February 2023, Prime Minister-cum-Finance Minister Y.A.B. Datuk Seri Anwar Ibrahim tabled the revised Budget 2023, which comes with many notable changes in branding and key fiscal ideas. It remains expansionary, as expected, with a total allocation of RM386.1 billion, making it the biggest budget in history. The upward revision from RM372.3 billion — tabled by the previous government in October last year — is appropriate due to the better-than-expected FY2022 economic performance.

- The budget size matters as the government needs the right fiscal power to steer the economy through global growth moderation in 2023. The government projects the economy to grow by 4.5%, which aligns with Bank Islam's current real GDP growth projection.

Budget 2023 Spending Allocation

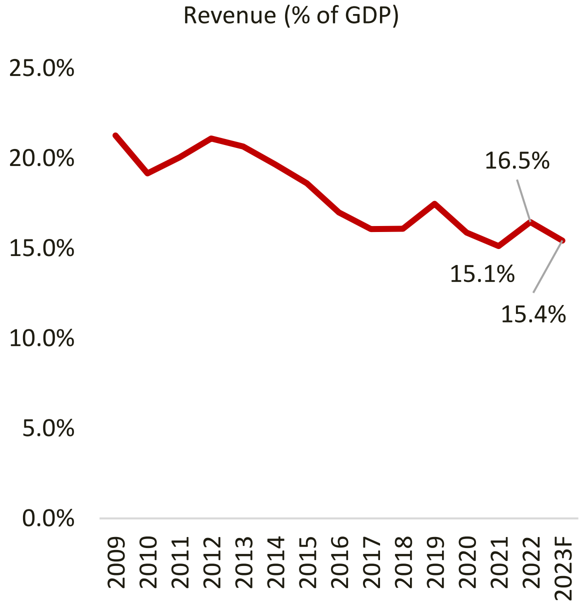


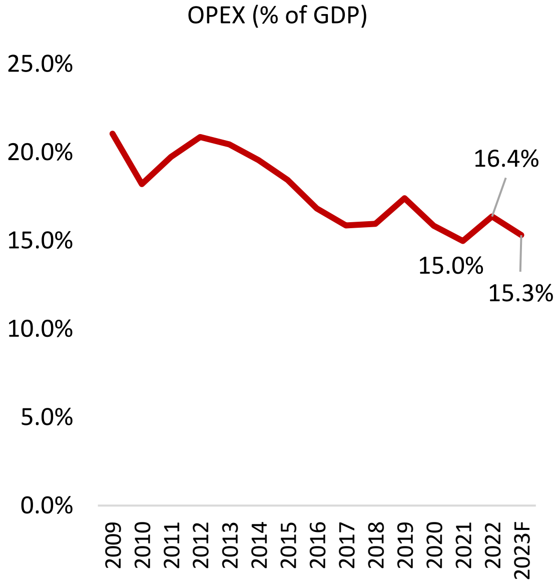
Sources: MOF, Bank Islam
*Note: *Development Expenditure*

- Revenue is expected to moderate to RM291.5 billion (2022: RM294.4 billion) or 15.4% of GDP this year in view of the slower global economic outlook. We concur with the government's global oil price assumption, which is now lower at USD80.0 per barrel from USD90.0 per barrel in the previous iteration of the budget. The government expects revenue-to-GDP to settle lower at 15.4% (2022: 16.5%) amid lower non-tax revenues, particularly investment income.

- Breaking it down further, the government projects tax revenues to increase from RM208.8 billion in 2022 to RM218.3 billion in 2023. However, we believe that it may be overstated because of; 1) lower corporate income tax due to the expiry of *Cukai Makmur*, 2) higher-than-expected tax foregone following the personal income tax rate adjustments among M40 and T20 income earners, and 3) lower wage growth in 2023 than in 2022. Amongst the components of direct tax, the Petroleum income tax (PITA) is the only component projected to come down, possibly because of the lower global oil price assumption in 2023. We concur with the government's lower indirect tax revenues to decline from RM55.3 billion in 2022 to RM54.1 billion in 2023 amid living cost issues and lower vehicle sales. In contrast with government projections, we opine that non-tax revenues will be somewhat similar to 2022 as global oil prices will likely remain elevated throughout the year.

- Operating expenditure (OE) is projected to decline to RM289.1 billion (2022: RM 292.7 billion), or 15.3% of GDP, in 2023. While emoluments are expected to increase, the government expects retirement charges to decline by 1% in the year. Debt service charges will continue to be higher than the administrative level of 15%, and perhaps more so due to a higher development expenditure (DE) in 2023. The government decided not to pursue subsidy rationalisation this year, yet we noticed a smaller allocation for subsidies and social assistance (2022: RM67.4 billion, 2023: RM58.6 billion).

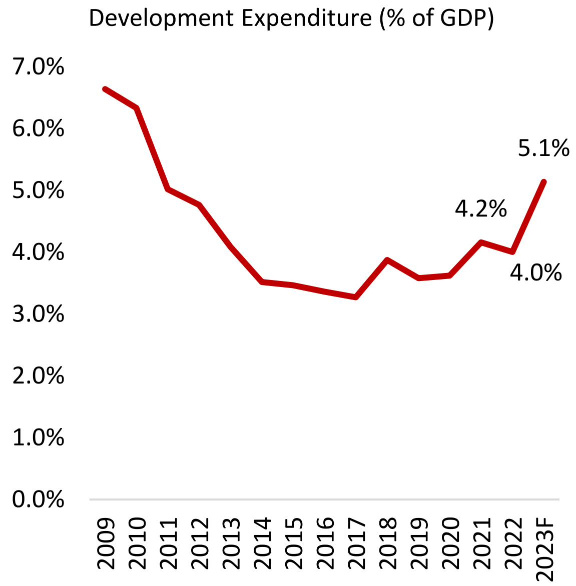


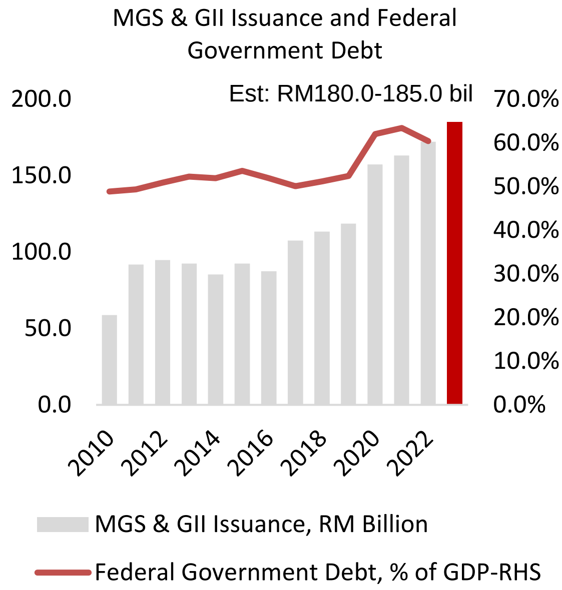


Sources: DOSM, MOF, Bank Islam

- DE is significantly higher (2022: RM71.6 billion, 2023F: RM97.0 billion), equivalent to 5.1% of GDP. It is higher than the one presented in October 2022, making it the highest DE in history in ringgit terms. The financial (RM21.9 billion), transport (RM17.6 billion) and education and training (RM13.6 billion) are the top three beneficiaries of such allocation. We wished there was a much more granular DE breakdown to estimate the multiplier effect on growth.

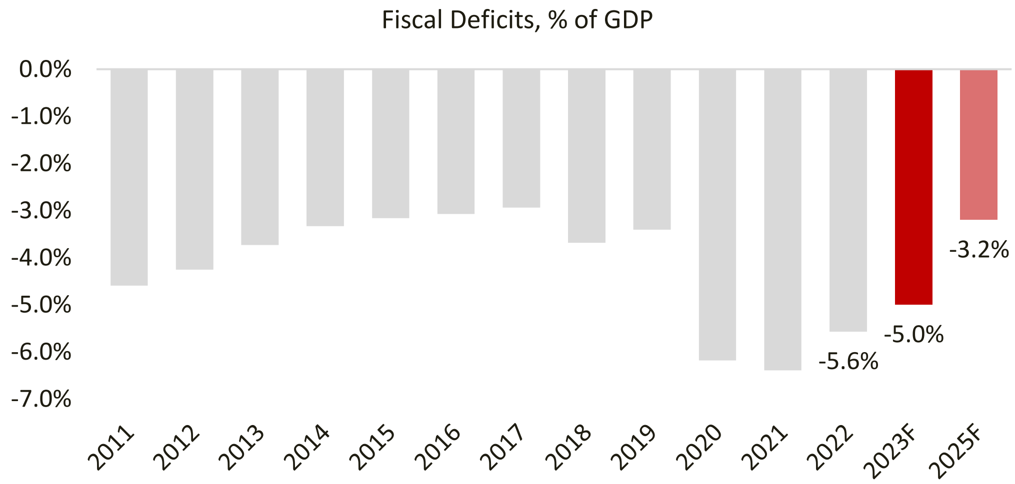
- Following the historic-high DE, we expect the issuance of MGS and GII to be around RM180.0 – RM185.0 billion in 2023. Debt-to-GDP ratio has decreased to 60.4% in 2022 (2021: 63.4%) despite a higher debt level of RM1,079.6 billion (2021: RM979.8 billion), thanks to the high nominal GDP growth rate in 2022. Statutory debt-to-GDP (MGS, GII and MITB) currently stands at 57.7%, thus we believe there is ample headroom for the government to accumulate debt in the year without impacting the statutory debt ceiling of 65.0%.





Sources: DOSM, MOF, Bank Islam

- The government projects its fiscal balance to come lower at -5.0% by the end of 2023 (2022: -5.6%) amid 5.6% nominal GDP growth, lower OE, and the expiry of the Covid-19 fund. The government targets a fiscal deficit of 3.2% of GDP by 2025.
- We believe that investment income may come in higher than projected amid elevated global oil prices. Furthermore, we suspect that opex may be underestimated because of retirement charges and subsidies and social assistance. We notice that retirement charges have steadily risen since the Global Financial Crisis and will continue so as more civil servants retire from service. Subsidies and social assistance may also come in higher than projected sans subsidy rationalisation. While global oil prices remain elevated, RON95 will likely remain at RM2.05 per litre throughout the year, suggesting that petroleum-related subsidies will continue to be high in 2023. Considering that personal income rate tax adjustments are not matched with higher indirect tax collection, the need to broaden the tax base will become more urgent with time.



Sources: MOF, BNM, Bank Islam

PART TWO: THE PLUSSES AND MINUSES OF THE REVISED BUDGET 2023

- We laud the following measures:
  - ***Greater fiscal discipline through legislation.*** The Government Procurement Act and Fiscal Responsibility Act bills will be proposed to support the nation's development agenda to enhance governance, accountability and transparency. The government will reintroduce an industrial master plan (New Industrial Master Plan - NIMP 2030), perhaps taking where it left off after the Third Industrial Master Plan (2006-2020) and the Industry4WRD plan. This will, in turn, make fiscal policy formulation more predictable and transparent in the future.
  - ***Accelerating key infrastructure projects.*** The government is committed to accelerating at least four infrastructure projects, such as the Jendela digital infrastructure project (RM725.0 million), the completion of repair works on 400 clinics in poor conditions and 380 dilapidated schools (RM1.2 billion), maintaining and upgrading federal roads (RM2.7 billion), and new and existing rural roads (RM1.5 billion). Considering the time value of money, early completion of key infrastructure projects will unleash a greater multiplier effect on the overall economy.
  - ***In theory, high DE will improve Malaysia's future growth rates.*** Focusing on high-impact investment will not only revitalise the Malaysian economy but also push wage growth higher. The Economic sector will receive the highest allocation of RM55.0 billion (2022: RM39.1 billion) or 56.7% of total DE, led by Transport (RM17.6 billion). Prime Minister Anwar Ibrahim said that the government will proceed with the MRT3 project at a lower cost of about RM45.0 billion instead of the proposed RM68.0 billion.
- However, we are concerned about:
  - ***The lack of clarity in addressing moderating growth.*** We posit that the Malaysian economy will decelerate to 4.5%, along with global growth moderation in 2023. Notwithstanding the budget size, it is unclear how the government intends to sustain its growth rates with lower revenues and OE in 2023. We share the government's concern about its debt level, but it appears that the bulk of the RM97.0 billion DE will be financed by debt. Furthermore, exports have started to lose steam in 4Q2022 following global recessionary fears and the semiconductor downcycle. Yet, there is little emphasis on boosting exports or, at least, alleviating producers' pressure on rising input prices.
  - ***Foregone tax revenues due to personal income tax rate adjustments.*** We believe that the government needs to clarify the updated boundaries for B40, M40 and T40 groups as the current income classification is still based on the 2020 Household Income and Basic Amenities Survey Report. The proposed personal income tax adjustments will cost the government RM900 million in tax foregone in 2023 alone, and the figure will become higher in time so long as the tax rates remain. We should also note that personal tax rates did come down following the introduction of GST in 2015, yet they remained static after the GST was abolished in 2016.
  - ***Short-term relief measures could keep inflation elevated.*** Overall, we laud the government's effort to address the needs of vulnerable segments of the Malaysian population. Various income support measures, including *Sumbangan Tunai Rahmah*, of up to RM3,100 to *e-kasih* recipients, could help reduce cost-of-living pressure. However, we foresee food prices will continue to remain elevated amid prolonged supply-side pressure and unfavourable foreign exchange rates. So, prices could remain elevated for longer. Bernas' profit-sharing scheme with rice farmers could also push rice prices higher. We foresee an aggressive price control drive in 2023. Should the unemployment

rate decline along with a full services sector recovery amid China's economic reopening, inflation may rise and necessitate a response from monetary policy.