2021 Outlook & Budget: Fiscal pump-priming to reinvigorate growth

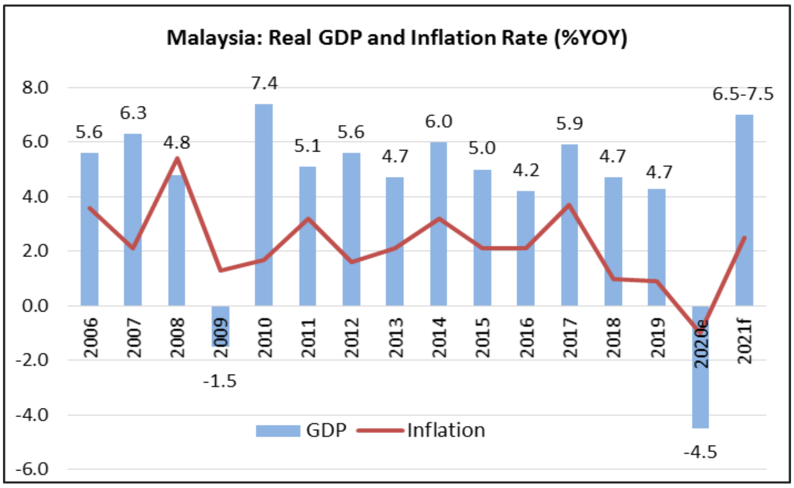
The Ministry of Finance (MOF) projected a reasonably upbeat growth picture, expecting the Malaysian economy to rebound and expand between 6.5-7.5% in 2021, benefitting from a low base after contracting 4.5% this year. This came in close to our house view for a 4.9% contraction this year before rebounding to 6.0-6.5% in 2021. Over the medium term, growth is expected to normalize to more sustainable level of 4.5-5.5% over the next three years as projected under the Medium Term Fiscal Framework (MTFF).

Recovery is expected to be broad-based led by domestic demand with both the private and public sectors bouncing back, supported by fiscal pump-priming under the expansionary budget. Budget allocation jumped to RM322.5bn in 2021 (21% of GDP) while 2020 allocation has also been revised higher to RM314.7bn (original RM297.0bn). Worth mentioning, development expenditure jumped a whopping 38.0% to RM69.0bn, its biggest increase since 1990. Transport (22%) and education & training (13%) continued to get the biggest chunk of the pie. Despite the increases in spending, budget deficit is expected to narrow a tad, but remained elevated at RM84.8bn or 5.4% of GDP in 2021 (2020: RM86.5bn or 6.0% of GDP), translating to potential gross MGS/GII issuances of RM153.5bn for 2021 (2020: RM149.9bn). Budget deficit is expected to narrow to 4.5-5.5% of GDP over the next three years, somewhat alleviated risk to sovereign rating downgrade.

Unsurprisingly, the latest budget measures are designed to boost individual/ household consumptions via income transfers as well as indirect support for the labour market to ensure that jobs are secured and livelihood safeguarded. The measures would also help alleviate the cash flow problems faced by the lower income segments. There were also quite sizeable tax incentives to attract and promote investments but this may require a longer gestation period to be filtered down to the broader economy.

The benchmark FBMKLCI and the MYR rallied post announcement, probably shrugging off an event risk. We are neutral to bullish MYR in the week ahead, expecting USD weakness to resume as soon as the election jitters dissipate. Today's pump-priming budget to revitalize growth is also expected to be positive for the MYR near term. No change to our end-2020 USDMYR forecast of 4.13 before further move to 4.08-4.10 in 1H2021.

2020-2021 Growth Prospects



Source: MOF Economic Outlook 2021

Real GDP growth to rebound sharply to 6.5-7.5% in 2021, helped by a low base in 2020

- Based on the latest Economic Outlook 2021 Report released by Ministry of Finance (MOF) in conjunction with the tabling of 2021 Budget, **the Malaysian economy is expected to rebound strongly from 2020's recession, expanding by 6.5-7.5% in 2021 (point forecast @ 6.9%).** This is largely in line with the 5.5-8.0% range projected by BNM earlier, and a tad more bullish than our in house forecast of 6.0-6.5%. This headline growth number looks impressive and way above potential level and past ten years average of 5.3%, skewed by statistical effect from the contraction in 2020 (MOF estimate: -4.5%; HLB estimate: -4.9%).

Normalized growth of 4.5-5.5% over three years

- **Growth is expected to normalize to 4.5-5.5% over the next three years** as portrayed by the Medium Term Fiscal Framework (MTFF 2021-2023). This is slightly higher than the previous MTFF projection of 4.5-5.0% over 2020-2022 after accounting for the higher growth projection for 2021. The lower end of the projection however remains at 4.5%, implying underlying downside risks.

Broad-based recovery anchored by domestic demand

- **MOF expects a broad-based recovery across all segments** of the economy spanning domestic to external sectors. Again, **domestic demand will continue to be in the driver seat, with an expected turnaround to +6.9% YOY in 2021 (2020: -3.0%) amid robust expansion in both the private and government sectors.**

Better job prospects and accommodative policies to support private consumption

- Within the private sector, **private consumption is expected to increase 7.1% YOY in 2021** (2020: -0.7%), underpinned by improvement in the labour market, accommodative policies and further recovery in external demand. **Private investment is also expected to rebound and grow 6.7% YOY in 2021** (2020: -11.7%), spurred by specific funds and incentives to revitalize investment and spillovers from fiscal injection. Meanwhile, **growth in the public sector (+6.7% vs -2.1% in 2020), will be underpinned by sustained growth in government spending and a hefty turnaround in public investment** (+16.9% vs -9.3% YOY) supported by infrastructure projects such as Klang Valley Double Track Phase 1 (KVDT1), MRT2, LRT3, Rapid Transit System (RTS) and Pan Borneo Highway.

Rebound in exports riding on recovery in global trade and supply chain disruption

- **On the external front, exports are expected to recover and grow 8.7% YOY in 2021 (2020: -13.4%), along with recovery in global trade and supply chain disruption.** Improvement in demand for E&E, chemicals & chemical products, rubber products, palm oil, as well as anticipated higher crude oil prices, are all expected to augur well with export prospects.

Back into mild inflation from deflation

- **Inflation is expected to make a return following the transitory deflation in 2020.** CPI is expected to bounce back up to 2.5% in 2021 (2020: -1.0%), back to the long run average range of 2.0-3.0%, in line with improvement in economic outlook and higher crude oil prices. This is a tad more upbeat than our in house CPI forecast of 1.3% (2020: -1.0%).

Unemployment rate to improve to 3.5% in 2021

- **Unemployment rate is expected to improve to the more normal level of 3.5% in 2021** (2020: 4.2%), continued pulling back from a high of 5.3% in May-2020 amid a surge in job losses triggered by shocks from the pandemic.

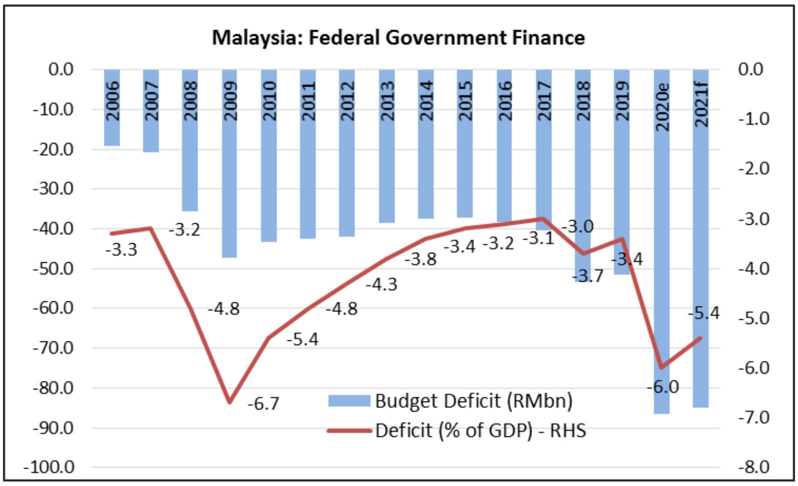
Current account surplus continued narrowing in 2021 as a result of wider deficits in income accounts

- **Current account surplus is expected to narrow further to RM20.3bn, representing 1.3% of GNI in 2021** (2020: RM45.5bn or 3.4% of GNI). **Higher surplus of RM82.5bn in the goods and services account is expected to be offset by bigger shortfall in the primary income account** (-RM41.6bn vs –RM23.7bn), where the deficit in investment income is expected to more than double to RM33.0bn due to higher repatriation of profits and dividends by foreign investors. **Deficit in the secondary income account is also expected to**

jump to RM20.6bn in 2021 (2020: -RM8.5bn), amid higher remittances by foreign workers following a revival in economic activities.

Budget deficit to remain elevated at 5.4% of GDP amid massive fiscal pump-priming to revitalize growth

- On the fiscal front, **budget deficit is expected to stay elevated at RM84.8bn in 2021, accounting for 5.4% of GDP.** Despite the massive increase in spending, budget shortfall pulled back slightly from the record high deficit of RM86.5bn in 2020 (6.0% of GDP), as the projected 4.2% YOY increase in revenue to RM236.9bn is expected to offset the increases in both operating expenditure (+4.3% YOY to RM236.5bn) and development expenditure (+39.2% YOY to RM68.2bn). The higher GDP base following the recovery in the economy also contributed to the lower deficit-GDP reading. **The phenomenal widening in the budget shortfall will no doubt increase sovereign rating downgrade risk,** where S&P and Fitch Rating had already placed us on negative rating watch earlier this year. It seems unlikely that we could return to the 3.0% threshold for deficit-GDP in the foreseeable future (4.5% under MTFF for 2021-2023).



Source: MOF Fiscal Outlook 2020

Government debt to GDP slightly breached the 60% debt ceiling as at end-September

- **Total federal government debt has risen by 10.3% to RM874.3bn as at end-Sept 2020, translating to 60.7% of GDP** (Dec-19: RM793.0bn; 52.5% of GDP), slightly above the newly revised statutory debt ceiling of 60%. While MOF was projecting a pullback to 59% at the end of the year, we are less confident that the debt level will decline much given that massive fiscal spending is still required to steer the economy back to its normal growth path. Little change from previously, the bulk of the debt (96.6%) is Ringgit-denominated borrowings, with the remaining 3.4% from offshore borrowings (mainly USD) suggesting minimal exposure to foreign currency risk.

Key Take-away from the 2021 Budget

2020 budget allocation revised higher to reflect various stimulus packages

- **The 2020 budget allocation was revised higher by about 6.0% to RM314.7bn**, from the initial estimate of RM297.0bn tabled by the Pakatan Harapan government last November. **The additional spending reflected** incumbent government's **various stimulus measures** aimed at combating the pandemic downturn. Excluding these additional stimulus programs, total revised budget for 2020 stood at RM276.7bn, thanks to the RM20.3bn savings generated via reviewing of existing projects and savings due to delayed implementation of projects during the MCO period.

Fiscal Injection from Covid-19 Stimulus Packages	
PRE (Feb)	RM3.2bn
PRIHATIN Rakyat (Mar)	RM21.8bn
PRIHATIN SME (Apr)	RM10.0bn
PENJANA, (Jun)	RM10.0bn

Source: MOF

Higher budget allocation of RM322.5bn for 2021, of which 73% goes to operating expenditure

- **The 2021 allocation was increased to a phenomenal RM322.5bn which represents 21% of GDP.** This is an increase of RM25.5bn or 8.6% from the unrevised initial 2020 budget (RM297b) and RM7.8bn or 2.5% from the revised 2020 budget (RM314.7bn). **Breakdown of allocations are operating expenditure (RM236.5bn or 73% of total), development expenditure (RM69bn or 21%) and Covid-19 Fund (RM17bn or 5%).**

Modest increase in revenue driven by higher tax collection

Federal government revenue is expected increase modestly by 4.2% to RM236.9bn in 2021 (2020: -14.0% to RM227.3bn). Tax collection is projected to increase by 13.8% to RM174.4bn (2020: -15.1% to RM153.3bn). Improving economies and higher earnings expectations are expected to drive the 15.1% growth in income taxes collection to RM123.1bn; indirect taxes are estimated to grow by 11.4% to RM42.5bn thanks to higher SST contributions (+13.7% to RM27.9bn) amid rebound in consumer spending.

Further decline in petroleum related revenue amid modest oil price assumption of $42/ barrel

Petroleum related revenue is expected to decline further by 24% to RM37.8bn in 2021 (2020: -40.3% to RM50bn), reflecting reduced reliance on petroleum revenue **(16% of total revenue in 2021 vs 22% in 2020).** Petroleum direct tax however is expected to rebound by 52% (2020:-58.9%) on oil price assumption of $42/barrel and more optimistic demand outlook. **The modest oil price assumption suggests room for some upside surprises in revenue** and hence deficit should global oil prices recover more than expected.

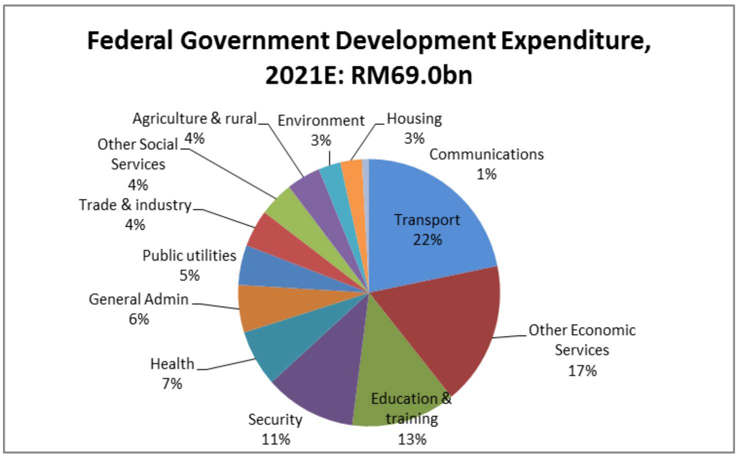
Similarly modest increase in operating expenditure due to higher emoluments

- **Operating expenditure is projected to increase by a similar quantum of 4.3% to RM236.5bn** (2020: -13.9% to RM226.7bn) as a result of higher emoluments that was driven by increments in civil servants' salary as well as pension charges.

Development expenditure to increase a whopping 38% to RM69.0bn…

…transport, education & training the biggest recipients

- **Development expenditure was raised by a whopping 38.0% from RM50.0bn in 2020 to RM69.0bn in 2021,** after two consecutive years of reductions. This also marked DE's **largest increase on record in terms of absolute amount and the steepest percentage gain since 1990 (+39%).** Sectors that are receiving notably higher allocations are trade & industry, transport, communications, education & training, healthcare and defense. **Transport (22%) and education & training (13%) continued to get the biggest share of the pie.**



Source: MOF Fiscal Outlook 2021

Key Budget Measures

- Unsurprisingly, the latest budget measures were designed to boost individual/ household consumptions via income transfers as well as indirect support for the labour market to ensure that jobs are secured and livelihood safeguarded. The measures also serve to alleviate the cash flow problems faced by the lower income segments. Among the key measures that impact individuals more directly include:

  - Lower EPF contributions from 11% to 9% starting January 2021, for 12 months, releasing a total of RM9.3bn (about 0.6% of GDP).

  - 1ppts reduction in income tax rate for those earning between RM50,001 and RM70,000 per annum, translating into tax savings of RM200, to benefit 1.4 million taxpayers staring YA2021.

  - Lifestyle tax relief to be increased to RM3,000 (previous: RM2,500), from YA2021.

  - Tax relief for medical expenses for self and individual for serious diseases to be increased from RM6,000 to RM8,000; cap on tax relief for full medical check-up to be raised from RM500 to RM1,000. Scope of tax relief for medical treatment expenses will also be expanded to include vaccination expenses for tax payers, spouse and child. From YA2021.

  - Tax relief for expenses on medical treatment, special needs and parental care to be increased from RM5,000 to RM8,000, starting YA2021.

  - The Bantuan Sara Hidup (BSH) assistance package will be changed to Bantuan Prihatin Rakyat (BPR) targeting household and individual of income ranges from less than RM2500 and up to RM5001. This is expected to amount to RM6.5bn benefitting 8.1m people.

  - Minimum RM100 per child up to a maximum of RM400 per family for those below the poverty line.

- Ex-police force personnel and recipients of medals for services rendered are entitled toRM500 one-off payment that will benefit about 40,000 recipients.

- Civil servants from Grade 56 and below will also be given a special one-off payment of RM300 in 2021.

- Withdrawal of EPF savings from Account 1, as much as RM500 per month and up to RM6,000 for 12 months, benefiting 600,000 members. (0.2% of GDP)

- Full stamp duty exemption given to transfer of ownership document and loan agreement for the purchase of a first home worth not more than RM500,000 (previous RM300,000). This exemption applies to purchase agreement from January 2021 to Dec 31, 2025.

- Tax relief of up to RM3, 000 to individuals investing in Private Retirement Scheme (PRS), will be extended for another four years to 2025.

- A short-term employment programme called "MyStep" worth RM700mil to offer 50,000 contractual job opportunities in the civil service and government linked companies (GLCs) from January 2021.

- The wage subsidy programme with an allocation of RM1.5b to be extended for another three months, in a targeted manner especially for those in the tourism sector.

- On the loss of employment the ceiling for tax relief has been increased from RM10,000 to RM20,000 for each full year of service, for YA2020 and YA2021.

- In the capital markets, another RM100m tranche of SUKUK PRIHATIN will be allocated to subscribers. Equity Crowd Funding (ECF) for start-up companies will also benefit from tax relief of 50% or RM50 000 of amounts invested under the purview of SC. In addition, existing income tax exemption on grant for Green SRI sukuk be expanded to all SRI sukuk and bond which meets the ASEAN Green, Social and Sustainability Bond Standards, for a period of five years. Stamp duty exemption on contract notes for trading of ETC be extended for another five years, from 1 Jan 2021 to 31 Dec 2025.

- Infrastructure-related projects will be allocated RM15b to fund various projects like the Gemas-JB electrified double-tracking, Raid Transit System from JB to Woodlands, Singapore, MRT3 and also the Klang Valley twin-tracking project. However the HSR project is subject to further negotiations with the Singapore government.

Implications on USDMYR outlook

- **USD/MYR edged lower by one big figure, trading at 4.1335 as of writing from 4.14 prior** to the budget announcement, after having hit the low of 4.1350 earlier of the day. MYR is on track to wrap up the week with a modest but meaningful gain after having weakening slightly against the USD since mid-October.

- Looking ahead, **US election outcomes remain the major driver for the pair in the short term, with a wider trading range of 4.10-4.17 expected.** Current developments are pointing towards a Biden victory which is negative for USD. We also do not rule out the possibility of Trump disputing the result which could create some uncertainties and also demand for the greenback.

- Nonetheless, **the end of US elections would also pave way for a weaker USD in the medium term**, taking into account the Federal Reserve's accommodative policy versus BNM's gradual moves toward a neutral stance. We expect Malaysia's recovery prospect to be more sanguine heading into 2021, supported by robust fiscal stimulus, barring from any significant surge in Covid-19 cases. The possibility of re-imposing a strict nationwide lockdown that involves temporary shutdown of businesses is very low. **No change to our 4Q forecast on USD/MYR at 4.13.**

Implications on MYR bonds market

- **Revision of total gross MGS/GII issuances this year i.e. 2020** (based on revised deficit of RM86.4b) **is ~RM149.8b** for which RM133.8b has been successfully conducted at the time of writing**. Hence, we expect another RM16.0b for the remaining four (4) auctions for the year consisting of RM8.0b GII and RM8.0b of MGS bonds.**

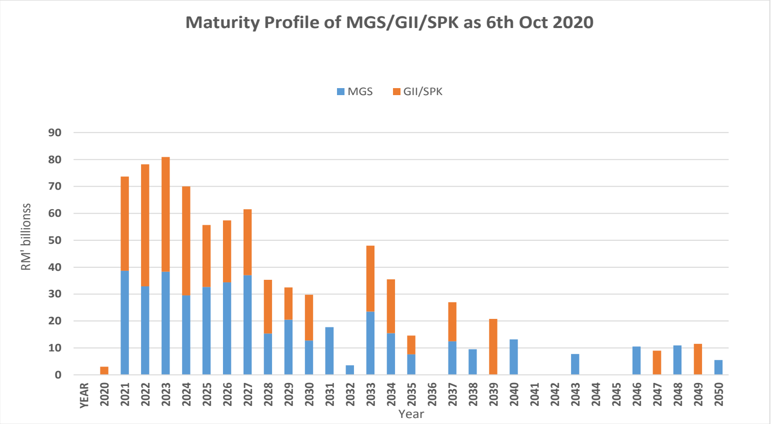
RM (Billion)	2019	2020	2021f
MGS/GII Maturities	69.0	73.4	73.7
Net Govt Bond Supply (MGS/GII)	46.7	86.4	84.8
1MDB cash proceeds	-	(10.0)	-
Gross Supply (MGS + GII + FCY bond)	122.7	149.8	158.5
Gross Supply (MGS+ GII only)	**115.7**	**149.8**	**153.5**

Source: MOF Fiscal Outlook Report 2021; BPAM, HLBB Global Markets Research

- Federal Government's **funding needs of RM158.5b for 2021 is expected to be majority-funded onshore up to RM153.5b by both MGS/GII** (with balance funded by a potential foreign currency bond issuance in the middle of 2021). Any shortfall is expected to be met by "special payouts" by PETRONAS with balance by other instruments e.g. Bills given that there is a scheduled USD Government of Malaysia (GoM) sovereign debt/sukuk of USD800m maturing in July 2021.

- **We expect MGS/GII issuances for 2021 to be distributed in a ratio of about 55:45 and skew towards the medium-longer end of the curve** taking into cognizance the high level of maturities from 2021-2027. Hence much of the anticipated issuances may hinge on a combination of 10Y-30Y tenures. We anticipate a busy issuance period beginning 1Q20 to reduce the impact of outflows taking into account some RM13.0b of maturities.

- **Going into 2021, based on scheduled MGS/GII maturities, there is a sizeable maturity window in 3Q2020.** Maturities are seen spiking in 3Q2021; forming the bulk i.e. ~44% of total. Given the safe-appeal status and comparatively attractive yields for MYR govvies in the face of a deluge of almost $17trillion of negative-yielding global debt; expect strong institutional support from both local and offshore supported by liquidity buffers. Hence, we expect reinvestments back into the govvies space from maturing MGS/GII.



Source: BPAM/ Bloomberg, HLBB Global Markets Research

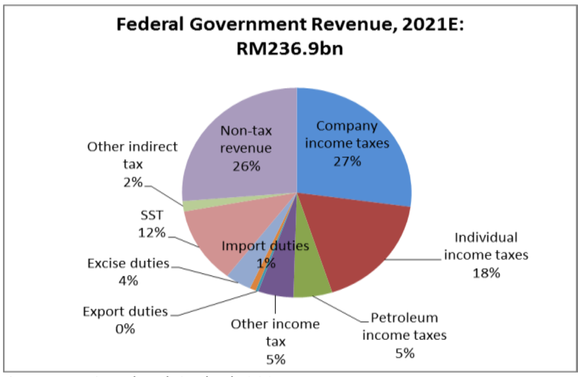
Quarter	2021	Stock	Monthly Maturity (RM'm)	Quarterly Maturity (RM'm)
	JAN			
1	FEB	MGS2/21	3,500	
	MAR	GII 3/21	9,500	13,000
	APR	GII 4/21	12,500	
2	MAY			
	JUN			12,500
	JUL	MGS 7/21	13,500	
3	AUG	GII 8/21	7,000	
	SEP	MGS 9/21	11,700	32,200
	OCT	SPK 10/21	6,000	
4	NOV	MGS 11/21	10,000	
	DEC			16,000
Total	Total		73,700	73,700

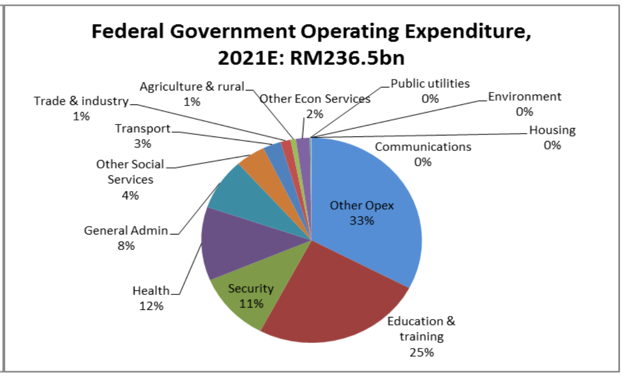
Source: BPAM/ Bloomberg, HLBB Global Markets Research

Federal Government Finance (RM million)

	2017	2018	2019	2020 ③	2021 ④
Revenue	220,406	232,882	264,415	227,270	236,900
% change	3.8	5.7	13.5	-14.0	4.2
Operating Expenditure	217,695	230,960	263,343	226,720	236,540
% change	3.6	6.1	14.0	-13.9	4.3
Current Surplus/Deficit	2,711	1,922	1072	550	360
Gross Development Expenditure	44,884	56,095	54,173	50,000	69,000
% change	6.9	25.0	-3.4	-7.7	38.0
Direct Expenditure	42,277	54,405	52,058	47,468	67,300
% change	5.6	28.7	-4.3	-8.8	41.8
Gross Lending	2,607	1,690	2,115	2,532	1,700
Minus Loan Recoveries	1,852	788	1,603	1,000	800
Net Development Expenditure	43,032	55,307	52,570	49,000	68,200
% Change	5.9	28.5	-4.9	-6.8	39.2
Covid-19 Specific Fund	-	-	-	38,000	17,000
Overall deficit	**-40,321**	**-53,385**	**-51,498**	**-86,450**	**-84,840**
% of GDP	**-3.0**	**-3.7**	**-3.4**	**-6.0**	**-5.4**
Sources of Finance					
Net External Borrowing	-342	-320	6,977	-303	-
Net Domestic Borrowing	40,750	54,427	44,755	87,501	-
Change in assets②	-87	-722	-234	-298	-

Note: ② Indicates a draw down of assets
③ Revised estimate
④Budget estimate
Source: MOF Fiscal Outlook 2021





Source: MOF Fiscal Outlook 2021

Balance of Payments (RM Billion)

	2016	2017	2018	2019	2020e	2021f
Balance on Goods	102.05	116.78	119.18	123.33	130.89	113.31
Balance on Services	-18.92	-22.86	-17.73	-10.92	-50.29	-30.87
Primary Income	-34.59	-38.66	-51.59	-40.27	-23.69	-41.56
Secondary Income	-18.63	-17.30	-19.28	-21.29	-8.46	-20.63
Balance on Current Account	**29.91**	**38.30**	**30.59**	**50.85**	**48.46**	**20.28**
Capital Account	0.10	-0.03	-0.09	0.33	-	-
Financial Account	-0.25	-4.73	11.43	-33.80	-	-
Direct Investment	*13.79*	*16.17*	*10.10*	*5.58*	-	-
Portfolio Investment	*-14.20*	*40.41*	*-49.40*	*-29.03*	-	-
Financial derivatives	*-0.80*	*-0.20*	*0.98*	*-0.48*	-	-
Other Investment	*0.96*	*-5.35*	*49.74*	*-9.87*	-	-
Errors & Omissions	-23.90	-17.13	-35.88	-8.97	-	-
Overall Balance	5.86	16.41	7.76	-8.42	-	-

Source: MOF Economic Outlook 2021

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