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Media Release

RAM Ratings: Malaysia's fiscal deficit target achievable in 2018

RAM Ratings opines that the projected narrowing of Malaysia's fiscal deficit target to 2.8% of GDP under Budget 2018, from an estimated 3.0% in 2017, is achievable and underscores the Government's commitment to long-term fiscal consolidation. Furthermore, the adjustment to the Government's Medium-Term Fiscal Framework (MTFF) targeted fiscal deficit to an average 2.4% of GDP throughout 2018-2020, from a near-balance target by 2020, is realistic and indicates a more gradual pace of fiscal consolidation.

Fiscal revenue is expected to increase 6.5% to RM240.0 billion in 2018 (2010-2015 average: +6.7%), as negative pressures ease. This will be largely driven by resilient economic growth (which should support GST collections) and a gradual recovery in global commodity prices (which will be positive for the Government's oil and gas (O&G)-related revenue). "Notably, O&G revenue is projected to exceed the Government's budgeted amount given its conservative assumed oil price of USD52 per barrel," highlights Esther Lai, RAM's Head of Sovereign Ratings. These factors are, however, balanced by tax rate reductions for 3 brackets of personal income taxes – which are estimated to have a fiscal impact of RM1.6 billion (0.1% of GDP) – and tax relief measures for companies.

Next year, operating expenditure is budgeted at RM235.7 billion (+7.2%), mostly due to higher amounts of social transfers in the lead-up to the 14th general election (GE). While the growth of emolument spending is likely to exceed the Government's projected 0.4% for 2018, arising from larger cash disbursements, the excess spending in this regard has been budgeted for in other line items. Additionally, we expect the continued roll-out of big infrastructure projects to elevate operating expenditure over the medium term, given such projects' maintenance and debt service charges.

While there is a higher likelihood of fiscal slippage leading up to the 14th GE, there is evidence that the Government's budgetary discipline has improved. Notably, fiscal slippage for emolument expenditure has been gradually declining since 2012 while spending on supplies and services was kept at 2.4% of GDP in 2016 and 2017 (2010-2015 average: 3.2%).

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Meanwhile, development expenditure is expected to remain flat at RM46 billion (3.2% of GDP) next year. This is lower than the RM52 billion average allocation implied under the 11th Malaysia Plan and also the average of 4.6% for 2010-2015. The slower rise of development expenditure underlines the Government's fiscal restraint, given its intention of containing its high debt levels and increasing use of off-balance-sheet sources of financing for large development projects.

Correspondingly, federal government debt remains elevated despite the anticipated decline to 50.3% of GDP by end-2018 (2017 estimate: 51.2%). The Government's hefty debt burden translates into a relatively high debt service-to-revenue ratio of 12.6% in 2018, i.e. higher than those of Malaysia's peers in the region (Thailand: 4.7%; Indonesia 11.7%). This is exacerbated by higher bond yields following the adjustment of the Foreign Exchange Administration rules in November 2016. That said, these effects have since partially normalised.

Nevertheless, the Government's contingent liabilities remained significant at 16.9% of GDP in 1H 2017, which imposes a continuous risk on its fiscal position. This ratio is estimated to rise to 18.4% by 2023, premised on our expectation of existing and upcoming infrastructure projects as well as the Government's routine commitments to housing and higher-education loan agencies. That said, stricter oversight over the issuers of these debts is likely following the establishment of the Fiscal Risk and Contingent Liability Technical Committee, and a possible introduction of a limit on guaranteed debt in the future.

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