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Media Release

RAM Ratings: Malaysia's fiscal deficit expected at 3.3% of GDP in 2019

RAM Ratings projects Malaysia's fiscal deficit to narrow to 3.3% of GDP in 2019 (from an estimated 3.6% in 2018) amid still-resilient domestic demand growth, the implementation of various fiscal measures and ongoing institutional reforms. Significant one-off events next year, including a RM30 billion special dividend from Petronas and RM37 billion of tax refunds, are not envisaged to meaningfully affect Malaysia's medium-term fiscal trajectory per se. Meanwhile, the Government's Medium-Term Fiscal Framework, which targets an average budgetary shortfall of 3.1% of GDP throughout 2019-2021, is considered achievable and highlights its commitment to fiscal consolidation.

Fiscal revenue, excluding the Petronas special dividend, is expected to only edge up 1.4% to RM236.9 billion (or 15.5% of GDP) in 2019, a pale comparison to the 3.8% growth in 2017. This highlights the role of oil and gas (O&G)-related revenue - which is expected to account for 30.8% of total revenue (inclusive of dividends) next year - as a significant stop-gap revenue source as new fiscal measures are implemented. In the long run, Malaysia's revenue is envisaged to be less reliant on O&G-related earnings amid the introduction of new revenue sources and ongoing institutional reforms. These will be complemented, the medium term, by a likely increase in returns from its investments and by tapping other non-conventional sources of revenue.

Government expenditure, excluding the aforementioned tax refunds, is anticipated to increase 1.5% to RM277.6 billion in 2019, i.e. below the 2012-2017 average growth of 4.0%. The deceleration in fiscal spending is largely due to the better targeting of bonuses for civil servants, the restructuring of subsidies and social assistance programmes, as well as better managed spending on supplies and services. While these are commendable efforts vis-à-vis curtailing government outlays, we expect some loss in efficiency that may reduce the anticipated overall fiscal savings during the early implementation phases of these measures. Nonetheless, fiscal expenditure is envisioned to slow down following the recent downscaling, postponement and/or cancellation of big-scale development projects.

Meanwhile, government debt is projected to remain elevated at 51.4% of GDP in 2019, albeit lower than the estimated 51.6% in 2018. This ratio is significant as the country's debt-servicing cost of 14.2% of total revenue (excluding the special dividend from

Petronas) is elevated and trending upwards compared to Malaysia's regional peers. Moreover, these ratios are not fully reflective of the sovereign's indebtedness as various off-balance-sheet debts, which had been taken up to meet development objectives in the past, are being serviced by the Government under different expenditure items. Based on this definition, RAM estimates total effective debt to come up to 65.7% of GDP by end-2018. The cancellation of mega development projects and the Government's intention of limiting the use of debt guarantees as well as improving administrative procedures for public-private-partnership projects will gradually ease this ratio.

Institutional reforms will be pivotal to the determination of Malaysia's fiscal trajectory. Key measures that have been implemented by the new administration include better recognition of fiscal expenditure items, the introduction of zero-based budgeting, improved targeting of subsidies and social assistance programmes, and increased use of open tenders for project awards (as opposed to limited tenders or direct negotiations before). These will be complemented by the operationalisation of the Tax Reform Committee in 2018 – which will narrow Malaysia's tax gap, estimated at 20% in 2017 by the Inland Revenue Board – and the Debt Management Office (DMO) in 2019, which will streamline the use of debt issuance proceeds at various levels of government as well as consolidate and optimise the use of available financial resources. Other related legislature announced under Budget 2019 include the Government Procurement Act (2019) and the Fiscal Responsibility Act (2021), which are aimed at preventing unsustainable levels of expenditure.

The main risks to Malaysia's fiscal performance include the fulfilment of more fiscally onerous political commitments and lower-than-expected global energy prices, which would adversely affect its O&G-related earnings.

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