Mizuho Flash: Malaysia

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Budget 2023: Balancing Fiscal and Political Realities

In a nutshell: ***On the heels of the budget announcement on 7 October, PM Ismail Sabri Yaakob dissolved Parliament on 10 October, paving the way for elections in the near-term.***

It was clear from the Budget for 2023 tabled on Friday that the government attempted to balance fiscal and political realities, in what was always set to be an election budget. Admittedly, the uncertainty around the budget has increased and it will be ***up to the discretion of the incoming government whether to adopt or change the 2023 budget tabled on Friday****.*

As it stands, Budget 2023 tabled on Friday committed to fiscal consolidation and subsidy rationalisation, with the government targeting a narrower fiscal deficit of 5.5% of GDP in 2023 from a downwardly revised 5.8% in 2022 (original budget: 6% of GDP). However, the political realities of near-term elections, reflected by generous cash handouts, a high social assistance budget as well as income tax cuts for the middle-income segment, means that that the 2023 fiscal deficit deviates from the medium-term consolidation path (in that the deficit is wider than was originally intended).

This implies that fiscal policy will be more accommodative than was originally intended in 2023. With that, the onus of tightening policy amidst tighter global liquidity conditions falls squarely on Bank Negara Malaysia. We, therefore, reiterate our call for an upsized 50bp hike at its 3 November meeting. The risk is that elections this year could delay in implementing the budget, reducing the fiscal impulse and keeping BNM on a more predictable path of rate hikes.

Walking a Fiscal Tightrope

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Notwithstanding, the details of the budget were clear as day on the impending elections. But the government also managed to strike a balance between its political and fiscal realities. Fiscal consolidation was adhered to, albeit not the extent that was considered previously, but under the circumstances is noteworthy nonetheless. The fiscal deficit for 2023 was pegged at 5.5% of GDP from a downwardly revised 5.8% of GDP in 2022 (original budget estimate: 6% of GDP).

Both revenue collections and expenditures are forecasted to be lower next year compared to the revised 2022 budget. This, however, accounts for large upward revisions in the revised 2022 budget compared to the original. Specifically, revenue collections estimates are revised to 22%YoY from 2021 versus 0.1% original budget while expenditures are expected to rise 19.3% YoY versus 2.8% in the original budget.

Revenue collections are expected to fall 4.4% YoY in 2023 mainly on account of non-tax revenues, i.e. **Petronas dividends reduced from MYR50bn to MYR35bn.** Meanwhile, tax revenues are expected to rise 3.7% YoY; trailing than nominal GDP growth of 4-5%, likely accounting for the 2% income tax slab cut across the middle-income brackets.

The expenditure side of the equation is also forecasted to be 3.4% YoY lower than in 2022 mainly on account of subsidy rationalisation, following a record subsidy bill in 2022. This year the government kept retail fuel prices at more than 100% below market prices[1] and raised subsidy allocations for cooking oil and poultry products. Development expenditures, by contrast, are projected to rise ~32% YoY, which we deem ambitious[2].

Budget at a glance

	2019	2020	2021	2022BE		2022 RE		2023 BE	
	MYRmn	MYRmn	MYRmn	MYRmn	%YoY	MYRmn	%YoY	MYRmn	%YoY
Revenues	**264415**	**225076**	**233752**	**234,011**	**0.1**	**285217**	**22.0**	**272570**	**-4.4**
Tax	**180010**	**154398**	**154398**	**171374**	**11.0**	**198227**	28.4	**205583**	3.7
Direct	135639	112511	112511	127334	13.2	147206	30.8	152392	3.5
Indirect	44371	41887	41887	44040	5.1	51021	21.8	53191	4.3
Non-tax	**83290**	**70678**	**70678**	**62637**	**-11.4**	**86990**	**23.1**	**66987**	**-23.0**
Petronas dividend	54000	54000	18000	25000	38.9	50000	177.8	35000	-30.0
Expenditures*	**315,913**	**312,720**	**322,540**	**331500**	**2.8**	**384700**	**19.3**	**371640**	**-3.4**
Current expenditures	**263343**	**224600**	**231516**	**233500**	**0.9**	**284700**	23.0	**272340**	-4.3
Emoulments	80534	82611	85854	86510	0.8	86510	0.8	90765	4.9
Subsidies	***23901***	***24186***	***23041***	***17,352***	***-24.7***	***58900***	***155.6***	***42016***	***-28.7***
Debt service charges	32933	34945	38069	43100	13.2	43100	13.2	46100	7.0
Others*	45557	9019	8517	5,203	-38.9	11804	38.6	7781	-34.1
Net development expenditures	**52570**	**50101**	**63267**	**75000**	**18.5**	**71200**	12.5	**94300**	**32.4**
Gross development expenditures	54173	51360	64257	75600	21.9	71800	11.7	95000	32.3
Less Loan recoveries	1603	1259	990	600	-25.0	600	-39.4	700	16.7
COVID-19 Fund	**n.a.**	**38019**	**37711**	**23000**	**-41.0**	**28800**	-23.6	**5000**	-82.6
Central government fiscal balance	-51498	-87644	-98757	-97,489		-99483		-99070	
%GDP	**-3.4**	**-6.2**	**-6.4**	**-6.0**		**-5.8**		**-5.5**	

Source: Ministry of Finance (MOF); Mizuho Bank.

Some Hits and Misses

Even in balancing political and fiscal realities, **Budget 2023 had some hits and some misses:**

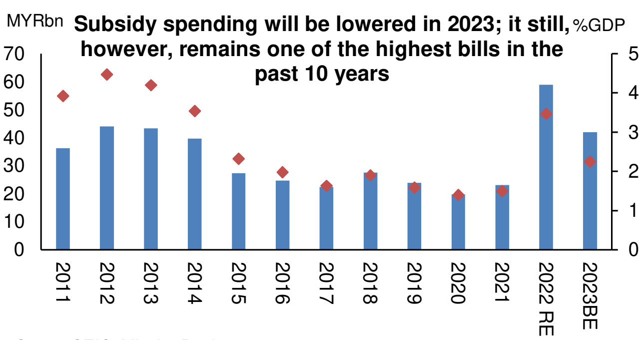
The low-hanging fruit, and to that extent a hit, was some amount of subsidy rationalisation that directly reflects a lower global oil price assumption for next year (USD90/barrel) but also includes a plan to introduce a targeted subsidy mechanism to ensure "equitable distribution of resources". The miss here was the government was remiss to not provide additional details, despite which the offset to lower income households in the form of cash handouts were maintained. Furthermore, the estimated ~29% drop in subsidies still means that the subsidy bill is ~2.2% of GDP, comparable to 2015.

[1] Ron 95 prices were maintained at MYR2.05/liter while the market determined RON 97 cost MYR4.45/liter in August. In addition to RON95, the government also subsidized diesel prices.

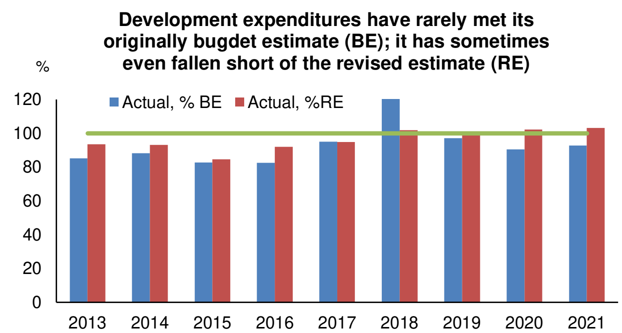
[2] Notwithstanding, the underlying assumptions of the budget are broadly reasonable: apart from real GDP growth which is estimated at 4-5%, inflation is projected to ease to 2.8%-3.3% in 2023 from 3.3% in 2022.

Sticking with expenditures, we see the significant jump in development expenditures as over ambitious and a potential miss. Historical precedence stands to bear that the government has traditionally undershot its development budget versus the original budget estimate, but also versus the revised estimate on many occasions. In any case, the potential undershooting of development expenditures allows for some leeway in reallocating those amounts towards operating expenditures.

Finally, in keeping with practical assumptions, the **government's assessment that revenue collections will be lower in 2023 compared to 2022 is reasonable.** However, there is a risk that revenues could fall below current assumptions given the generous income tax slab adjustments for middle-income segment.



Soure: CEIC; Mizuho Bank



Source: Ministry of Finance; Mizuho Bank

Fiscal consolidation to remain on track

The bottom-line is that government maintained its commitment to fiscal consolidation by lowering the 2023 fiscal deficit to 5.5% of GDP from 5.8% this year. That said, the larger-than-expected fiscal deficit and deviation from the previously stated medium-term consolidation path implies that policy will remain accommodative in 2023.

BNM on Track to an 'Upsized' Hike but Risks Rise Given Impending Elections

With that, the onus of tightening policy amidst tighter global liquidity conditions falls squarely on Bank Negara Malaysia. **We, therefore, reiterate our call for an upsized 50bp hike at its 3 November meeting.** The risk is that elections this year could delay the adoption and implementation of next years' budget, reducing the fiscal impulse and keeping BNM on a more predictable path of rate hikes.

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