Mizuho Flash: Malaysia

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Budget 2023: A Clear Election Bias

Ahead of Budget 2023, which will be tabled in Parliament on 7 October, there are (not-so-subtle) hints being dropped that the elections will be held in Q4 this year, well ahead of the September 2023 deadline. This makes the budget announcement significant for a few reasons including an obvious pre-election bias, which when combined with fading commodity price tailwinds could test the resolve of the government to stick to its medium-term fiscal consolidation agenda.

An election budget…

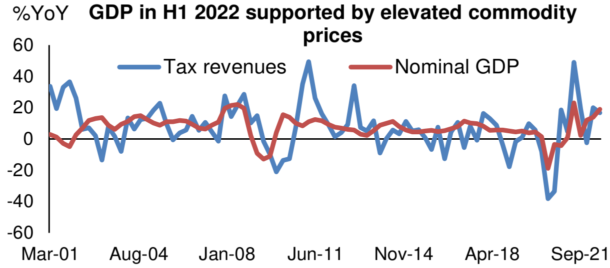
Budget 2023 was always to be set to be an election year budget. Malaysia's parliament needed to be dissolved by July 2023 and elections held by mid-September next year. However, following the meeting of the UMNO[1] Supreme Council held over the weekend, elections could happen within this year itself. More importantly, it is more than likely that Parliament will be dissolved shortly after the Budget is tabled on 7 October.

This raises the stakes for next year's budget, making its pre-election bias even more pronounced. We expect that the government will be focussed on providing cash handouts, continued subsidy support on fuel/utilities but will not entirely lose focus of the broader agenda of fiscal consolidation. The fiscal deficit target for next year maybe lower or similar to the 6% of GDP deficit targeted in 2022. However, **the quality of fiscal consolidation may not be ideal.** Fading commodity tailwinds in 2023 will make the trade-off between current expenditures and capex more acute as revenue collections will necessarily be lower compared to 2022.

…to follow on a commodity boosted budget

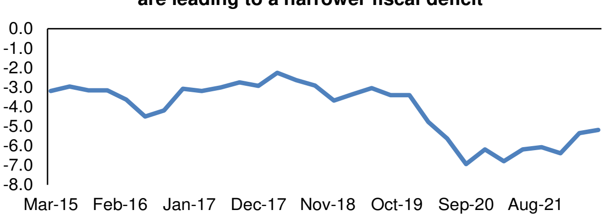
For this year, the upswing in commodity prices so far has led to windfall in revenue collections, allowing for an over-run in operating expenditures without having to cut back on development expenditures. Revenues collections jumped 16.3% YoY in H1 2022, above nominal GDP growth, boosted by higher tax revenues. Non-tax revenues in H1 were running at a slower run-rate but the doubling of Petronas dividends to MYR50bn from the originally budgeted MYR25bn[2] will more than compensate in H2.

Tax revenue collections rose faster than nominal GDP in H1 2022 supported by elevated commodity prices



Source: CEIC; Mizuho Bank

Fiscal deficit, 4-quarter rolling sum: windfall commodity revenues despite expensive subsidies are leading to a narrower fiscal deficit



Source: CEIC; Mizuho Bank

[1] The largest political party in Malaysia's Parliament

[2] Malaysia's Petronas reports profit jump; doubles dividend to government, 30 August 2022, Reuters.

This windfall in revenues allowed the government to maintain a generous subsidy bill, which has more than exceeded the entire budgeted amount for 2022 in H1 alone. Even so, (gross) development expenditures increased 7.4% YoY, albeit below the budgeted run-rate but respectable nonetheless. **With this, the fiscal deficit is at 5.2% of GDP for H1 2022 versus the full year 6% of GDP.**

This leaves room for the fiscal deficit to undershoot the annual target for this year. We expect the undershoot will be kept to a minimum especially since it allows the government to direct revenue windfall (from the commodity price upswing) towards greater social assistance and subsidies within the year, benefiting the election timeline to a greater degree.

Budget at a glance								
	2019	**2020**	**2021**	**2022BE**		**H1 2022**		
	MYRmn	MYRmn	MYRmn	MYRmn	%YoY	MYRmn	%YoY	% budget
Revenues	264415	225076	233752	234,011	0.1	124322	16.8	53.1
Tax	**180010**	**154398**	**154398**	**171374**	**11.0**	**94829**	**18.3**	**55.3**
Direct	135639	112511	112511	127334	13.2	67583	15.8	53.1
Indirect	44371	41887	41887	44040	5.1	27246	24.8	61.9
Non-tax	**83290**	**70678**	**70678**	**62637**	**-11.4**	**27003**	**31.8**	**43.1**
Petronas dividend	54000	54000	18000	25000	38.9	n.a.	n.a	n.a
Expenditures*	315,913	312,720	322,540	331500	2.8	160299	10.0	48.4
Current expenditures	**263343**	**224600**	**231516**	**233500**	**0.9**	**129812**	**10.6**	**55.6**
Emoulments	80534	82611	85854	86510	0.8	44408	2.7	51.3
Subsidies	***23901***	***24186***	***23041***	***17,352***	***-24.7***	***19035***	***80.3***	***109.7***
Debt service charges	32933	34945	38069	43100	13.2	19825	7.8	46.0
Gross development expenditures	54173	51360	64257	75600	21.9	30487	7.4	40.3
COVID-19 Fund	**n.a.**	**38019**	**37711**	**23000**	**-41.0**	**9408.3**	**-49.0**	**40.9**
Central government fiscal balance	-51498	-87644	-98757	-97,489				
%GDP	**-3.4**	**-6.2**	**-6.4**	**-6.0**				
Source: Ministry of Finance (MOF); Mizuho Bank.								

Fiscal consolidation to remain on track

Notwithstanding the outcome of the general elections, **we expect the new incoming government is unlikely to deviate from its stated fiscal consolidation agenda** of the deficit averaging 5.0% of GDP from 2022-2024. This implies that the **fiscal deficit will be narrowed to 4.5-5.0% of GDP in 2023**, allowing for the government to lower debt levels over the medium-term. In response to the pandemic, the government lifted the domestic debt ceiling to 65% of GDP but as of Q2, debt levels have fallen below 60% of GDP (as per the government's definition).

Monetary Policy Implications: BNM on Track to Hike

The governments' fiscal stance will keep BNM on a hawkish path. A modestly expansionary to neutral fiscal stance implies that BNM will have to shoulder the bulk of the responsibility in reining in price pressures. To that end, we remain comfortable with our call for BNM to hike by 50bp at its 3 November meeting.