Strategic Credit & Economic Analytics

SME BANK GROUP

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Economic Analytic | National Budget 2021 Preview

Balance between "Life" and "Livelihood"

- **An expansionary budget with more stimulus package for economic recovery**
- **Expect fiscal deficit to widen to 6.5% in 2020, before moderating to between 5.0 to 5.5% next year**
- **We anticipate GDP to decline between -4.0 to -6.0% Y-o-Y in 2020; before rebounding between 4.5-7.5% Y-o-Y in 2021**

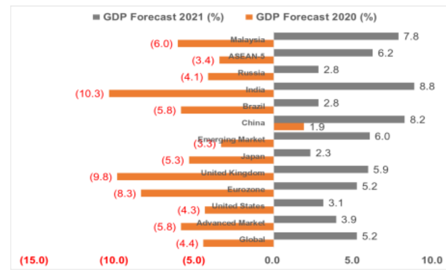
Budget 2021 is scheduled to be tabled on 6 Nov will for sure be an expansionary budget to provide more buffer for Malaysia's economic growth in the event of unprecedented event arising from current Covid-19 pandemic. The focus of Budget 2021 includes safeguarding the welfare of the people, driving economic growth, enabling sustainable living and enhancing public service delivery.

In 1H20, the Malaysian economy contracted 8.2% Y-o-Y (1H19: +4.7%) – registering the largest decline since the Asian Financial Crisis in 1998, largely dragged by the bottoming of Gross Domestic Product (GDP) during the second quarter (-17.1% Y-o-Y). The sharp decline in GDP was attributed to the unprecedented measures taken by the government to curb with the spread of pandemic, especially through movement and travel restrictions, and forced business closures that had severely curbed economic activities.

(% YoY)	2019	2020F	2021F	2Q19	3Q19	4Q19	1Q20	2Q20
Real GDP	4.3	-4.0	7.0	4.9	4.4	3.6	0.7	-17.1
Domestic demand	4.3	-3.8	8.2	4.5	3.5	4.8	3.7	-18.7
Real exports	-1.2	-7.4	9.6	0.5	-2.1	-3.4	-7.1	-21.7
Gov't budget balance (% of GDP)	-3.4	-6.5	-5.0	-3.1	-2.9	-3.4	-7.7	-7.8
Current account balance (% of GDP)	3.3	2.2	2.3	3.9	3.2	1.9	2.6	2.5
Inflation rate	0.7	-1.0	2.0	0.6	1.3	1.0	0.9	-2.6
Overnight policy rate	3.00	1.75	2.00	3.00	3.00	3.00	2.50	2.00
Money supply (M3)	3.5	5.0	4.0	5.3	4.3	3.2	3.7	5.6
Loan growth	3.9	3.0	3.5	4.4	3.8	3.9	4.0	4.1
USD/MYR (eop)	4.09	4.15	3.95	4.13	4.19	4.09	4.32	4.29

Source: DOSM, BNM

Global GDP Growth Forecast (%, y/y)



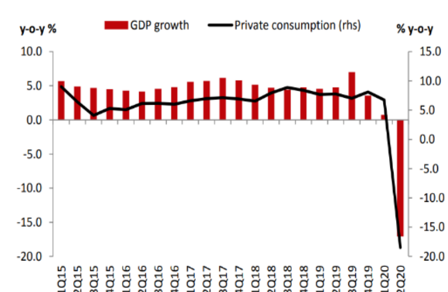
Source: IMF, Bloomberg, SME SCEA

Malaysia Growth Forecast until 2020

Economic Snapshot	2018	2019	2020 F
Real GDP (% YoY)	4.7	4.3	(-4.0) to (-6.0)
CPI (% YoY)	1.0	0.7	(-1.0) to (1.0)
CA (RM Billion))	33.5	49.7	30
OPR (% Year-end)	3.25	3.00	1.75
MYR/USD (Average)	4.04	4.14	4.25 to 4.35

Source: Bloomberg, CEIC, SME SCEA

Malaysia GDP vs Private Consumption



Source: Alliance DBS, CEIC, SME SCEA

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We are now expecting that GDP to post a large rebound in Q3, with a very strong bounce in consumer spending after the lockdowns. However, the re-surgence in domestic Covid-19 infections and tightening of the Movement Control Order will put a strain on the recovery going forward. As a result, we forecast the -4.0 to -6.0% slowdown in GDP for the full year 2020 and still expect solid growth in 2021. Downside risks predominate; on top of controlling the latest virus outbreak, political tensions remain elevated.

On the domestic public spending, it continued to expand at 3.6% y-o-y in 1H20 (1H19: +3.3%), largely due to the stimulus measures unveiled by the government to cushion the economic downturn. Public spending will remain the main pillar of growth in the upcoming quarters. During the first half of the year, Malaysia's external trade performance has been largely affected by the disruption of the global supply chain, with exports and imports declining 5.8% Y-o-Y and 6.3% Y-o-Y respectively (1H19: -0.4% y-o-y; -2.1% y-o-y). Moving forward, we anticipate Malaysia's external trade activities to remain susceptible to pandemic-induced global supply chain disruptions despite the gradual normalisation in domestic economic activities.

On the Monetary Policy, the cumulative 125bps cut in Overnight Policy Rate (OPR) YTD by Bank Negara Malaysia (BNM) has provided sufficient liquidity for the financial system and right injection for the recovering economy to regain its pre-pandemic traction for now.

The main focus of these stimulus measures and policy actions is mainly to address the concerns of income losses, job cuts and business closures during the crisis, various incentives and initiatives have been introduced that include but not limited to cash handouts to B40 and M40 household income groups, wage subsidy programme, loan moratorium, several tax relief and exemptions as well as provision of grants and loans to the severely affected businesses.

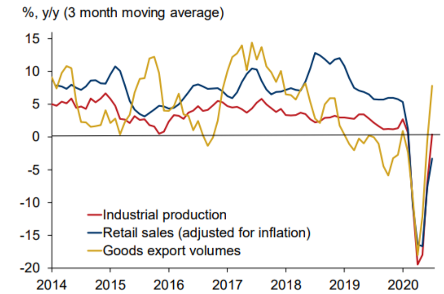
According to the Ministry of Finance (MOF), the fiscal measures are expected to contribute more than 3% of Malaysia's GDP in 2020 with multiplier effect. Revival of megaprojects, targeted subsidy and others will support domestic private consumption and investment growth plus government spending.

The 2021 Budget will be expansionary, albeit at a lower magnitude. We project an improvement in the fiscal deficit to minimum of 5.0% of GDP in 2021, from 6.5% in 2020. Revenue is expected to improve as better economic growth expected next year, but remain lower than pre-pandemic level seen. Similarly, expenditure is expected to narrow, given the absence of one-off extensive support measures. The Government has indicated that it is looking to expand the tax base, with all possible avenues being considered, i.e. sales & service tax (SST) expansion, inheritance, capital gains or carbon tax, and Goods and Services Tax (GST). However, given the weak economic momentum, it is likely that any such measures would be implemented at a later time.

Spending on social assistance is expected to remain significant, and special cash handouts may continue in 1H21. Similarly, targeted support to segments that continue to suffer, such as tourism and SMEs, may continue. As a result, we believed consumer segment will continue to be beneficiaries.

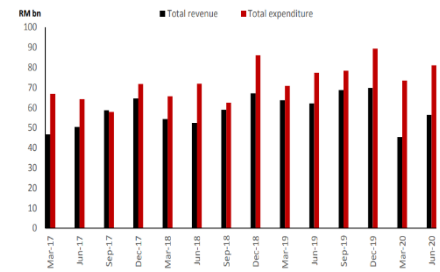
Development expenditure is projected to remain high at RM 60 Billion in 2021, given the weak private investment prospects and the need to remain economically

Malaysia: Monthly Indicators



Source: Oxford Economic/Haver Analytics, SME SCEA

Malaysia: Monthly Indicators



Source: BNM, Alliance DBS, SME SCEA

competitive. We expect the Government to maintain the current relief measures for the property market, and are hopeful it will consider lowering the Real Property Gains Tax (RPGT) further.

Government revenue to improve as economy is expected to rebound next year but not much can be expected for revenue collection. With companies currently hardly try to survive, the outlook for tax collection is set to be weak. In addition, elevated unemployment levels and reduced workers' compensation minimise the potential for any increase in income taxes. One possible avenue for an increase comes from the better outlook for commodity prices, which may benefit revenues tied to these commodities.

Support will generally come from the better economic environment, particularly towards the latter part of 2021. Tax collections will also be helped by the expiry of some tax relief measures introduced in 2020. Nevertheless, some fiscal support is expected to remain next year, although the scope will be more targeted. This should keep tax collections below trend. Personal income taxes have been quite resilient during past recessions, maintaining its upward trajectory despite tougher times. However, given the unprecedented rise in unemployment, as well as tax rebates and relief given to taxpayers, it is projected that tax collections will be noticeably lower in 2020. In addition, further income tax relief is expected, to help taxpayers cope with the challenges ahead.

We foresee few changes or announcement in the areas of:

i. Mobile work arrangements.
ii. Domestic travel/accommodation expenses to promote local tourism.
iii. Support for higher EPF contribution.
iv. Rebates for COVID-19 vaccination costs.
v. Digital tax is expected to rise.
vi. Measure to help SMEs will continue including digital transformation.
vii. Extension of direct cash assistance.
viii. Resumption of mega projects.
ix. Property-related sectors will be received continuous support.
x. Emphasising sustainable development and education. and
xi. Supplies & services could increase for vaccine procurement and the cost of implementation nationwide once a vaccine is available.

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