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Global Markets Research

Research Alert

Malaysia: 2022 Outlook & Budget

- **Record high budget allocation of RM332bn**
- **Realistic growth target of 5.5-6.5% for 2022, picking up from this year's 3.0-4.0%**
- **Elevated fiscal shortfall amid continuous expansionary budget to revitalize growth**
- **Positive impact on MYR; gross issuances of MYR government bonds to remain sizeable**

Key Takeaways and Our Thoughts

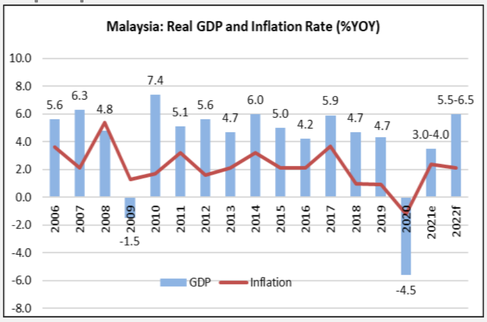
The Finance Minister tabled the 2022 Budget with a record high allocation of RM332bn today, focusing on the last three Rs of the Economic Recovery Plan, which is Recovery, Resilience and Reforms. Centring around the well-being of its people, resilient businesses and a prosperous and sustainable economy, this is a well-crafted budget attempting to address as many issues as possible in our view, in alleviating the pain of the people and businesses affected by the social and economic fallout from the pandemic, whilst providing the means to support and boost near term recovery, rebuilding resilience and driving reforms in the medium to longer term.

Given the need for continued expansionary fiscal policy, and constrained by the absence of new revenue stream, the budget deficit is expected to remain sizeable at RM97.5bn or 6.0% of GDP in 2022, albeit narrowing from the estimated record RM98.8bn or 6.5% of GDP in 2021 thanks to quicker expansion in the GDP base. Growth is expected to pick up further to 5.5-6.5% in 2022, from an estimated 3.0-4.0% in 2021 (HLB's 5.6% and 3.2% respectively), driven by broad-based albeit uneven recovery in both the domestic as well as external sectors. Noticeably, public investment is expected to rebound strongly riding on accelerated spending on major infrastructure projects whilst pent-up demand, improving labour market prospects and continuous policy support will quicken private consumption growth.

Over the more medium term, real GDP growth is projected to average at a more modest 5.5% over the next three years under the Medium Term Fiscal Framework (MTFF) 2022-2024, whilst budget deficit is projected to narrow to 5.0% of GDP based on crude oil price assumption of $67/ barrel. Based on the RM262.0bn estimated shortfalls over the three years, budget deficit will remain elevated averaging RM82.5bn a year in 2023 and 2024, though lower compared to the RM97.5bn deficit forecast for 2022. This implies gross issuances will remain sizeable. For 2022, we expect gross MGS/GII supply of circa RM167.0bn (2021e RM160.6bn), amid higher MGS/GII/SPK maturities of RM78.2bn (2021: RM73.7bn).

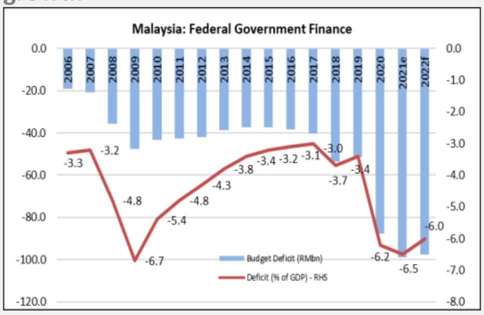
While supply concerns and a rising global bond yields environment are expected to exert some pressure on the local bond scene, we believe the depth and breadth of the domestic bond market will be able to navigate through such challenges. We also believe the positive vibes from today's expansionary budget to reinvigorate growth whilst keeping deficit concerns in check, as well as recovery story of the Malaysian economy, is positive for the MYR, pushing it towards the 4.10 handle against the USD.

Figure 1: Improving growth outlook; back to pre-pandemic levels in 2H2022



Source: MOF 2022 Economic Outlook

Figure 2: Fiscal deficit to narrow but remain high at 6.0% of GDP for 2022 amid extended policy support to revitalize growth



Source: MOF 2022 Fiscal Outlook

Macro Outlook

- **The Malaysian economy is expected to see quicker and more meaningful recovery in 2022,** according to the latest forecast by the Ministry of Finance (MOF). **Our GDP growth forecast of 5.6% falls within MOF's latest forecast range of 5.5-6.5%, but below its mid-point forecast of 6.0%, and will see a return to pre-pandemic levels in 2H2022.** For 2021, MOF's estimated growth forecast of 3.0-4.0% (midpoint: 3.5%) is on the same page with BNM's forecast range (HLB's revised estimate: 3.2%).

- Over the medium term as depicted under the Medium Term Fiscal Framework (MTFF), **average real GDP growth is expected to sustain at 5.5% over 2022-2024,** corresponding to the higher end of the 12MP's 5-year target of 4.5-5.5%, suggesting growth is expected to normalize from 2022's levels, as pent up demand subsides.

- **Recovery will be broad-based albeit uneven across all segments of the economy driven by pent-up demand and recovery in the global economy,** by and large. Domestic demand will remain the main pillar, expected to grow 6.6% y/y in 2022 (2021: +3.1%), with added impetus from the external sector (+6.8% vs +4.8% y/y). **Spending in the public sector is expected to pick up considerably** to 7.3% y/y in 2022 (2021: +1.6%) largely driven by investment and accelerated spending on large infrastructure projects such as the LRT3, MRT3, Johor-Singapore RTS, as well as Pan Borneo Highway and upgrading of Klang Valley Double Track Phase 2 (KVDT2). The private sector is also expected to see quicker expansion of 6.4% y/y (2021: +3.5%), thanks mainly to increases in private consumption supported by higher disposable income and better job market prospects and consumer sentiments as the economy recovers.

- **On the external front, exports are expected to normalize** to grow 4.2% y/y in 2022, while imports are also expected to track the same trajectory and increase only a modest 3.9% y/y in 2022. This is sharply lower from the 15.0% and 16.2% y/y growth estimated for 2021, **due to statistical distortions, which serves to negate global trade growth and improvement in supply chain.**

- **MOF expects inflation to stay above the 2.0% mark, albeit moderating to 2.1% in 2022 (2021: +2.4%),** more bullish than our projections for a 1.3% increase. Improving demand supported by recovery in economic outlook and labour market conditions, as well as stabile oil prices outlook, will be the key catalysts for CPI.

- **Unemployment rate is expected to improve to 4.0% in 2022,** a 0.6-0.8ppt improvement from the 2021's estimated unemployment rate of 4.6-4.8%, supported by further economic recovery. Total employment is expected to increase further by 2.3% to 15.5m, led by employment in the services sector (64.8%) followed by the manufacturing (16.6%) and agriculture (10.2%) sectors. However, it will take a longer than usual time, if ever, for unemployment rate to return to the long term average of 3.3-3.5% given the structural changes in the labour market.

- **Current account surplus is expected to sustain at RM55.6bn, representing 3.5% of GNI in 2022** (2021: RM56.7bn or 3.8% of GNI). **Higher surplus of RM121.3bn in the goods and services account is expected to be offset by**

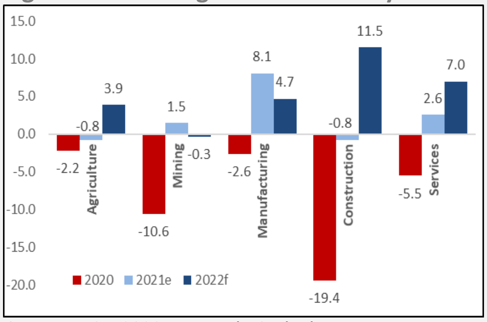
Figure 3: Medium Term Fiscal Framework (MTFF) 2022-2024

	2022 – 2024	
	RM BILLION	**SHARE TO GDP (%)**
Revenue	736.0	*13.9*
Non-petroleum	600.7	*11.3*
Petroleum-related	135.3	*2.6*
Operating expenditure	726.9	*13.7*
Current balance	**9.1**	***0.2***
Gross development expenditure	250.0	*4.7*
Less: Loan recovery	1.8	*0.0*
Net development expenditure	248.2	*4.7*
COVID-19 Fund[1]	23.0	*0.5*
Overall balance	**-262.1**	***-5.0***
Primary balance	**-122.6**	***-2.3***
Underlying assumptions:		
Average real GDP growth (%)	5.5	
Average nominal GDP growth (%)	7.7	
Average crude oil price (USD per barrel)	67	
Average oil production (barrels per day)	580,000	

[1] A specific trust fund established under Temporary Measures for Government Financing (Coronavirus Disease 2019 (COVID-19)) Act 2020 to finance economic stimulus packages and recovery plan
Note: MTFF estimate, excluding budget measures
Source: Ministry of Finance, Malaysia

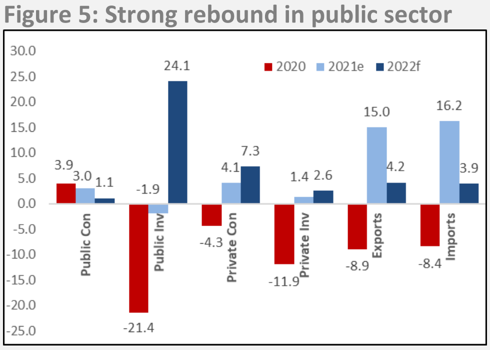
Source: MOF 2022 Fiscal Outlook

Figure 4: Uneven growth across key sectors



Source: MOF 2022 Economic Outlook

Figure 5: Strong rebound in public sector



Source: MOF 2022 Economic Outlook

bigger shortfall in the primary income account (-RM65.4bn vs –RM40.0bn), where the deficits in employee compensation and investment income are expected to widen to RM11.1bn (2021: -RM7.5bn) and RM43.3bn (2021: -RM32.5bn), the former due to revival in the number of foreign professionals in the country, and the latter due to higher repatriation of profits and dividends by foreign investors. On the contrary, **deficit in the secondary income account is also expected to moderate slightly to RM11.3bn** (2021: -RM12.7bn), attributable to lower remittances by foreign workers following the immigration restrictions on foreign labour.

- On the fiscal front, **budget deficit is expected to stay elevated at RM97.5bn in 2022, accounting for 6.0% of GDP.** Despite the massive increase in spending, budget shortfall pulled back slightly from the fresh record high deficit of RM98.8bn in 2021 (6.5% of GDP), as the projected 5.9% YOY increase in revenue to RM234.0bn is expected to offset the increases in both operating expenditure (+6.3% YOY to RM233.5bn) and development expenditure (+21.9% YOY to RM75.6bn). The higher GDP base following the recovery in the economy will also contribute to the lower deficit-GDP reading, hence alleviating the pressure on sovereign rating downgrade in the immediate term. That said, we do not expect the fiscal shortfall to narrow substantially in the near term given the policy need to maintain an expansionary fiscal policy to ensure sustainable economic recovery. Our view is somewhat confirmed by the **average fiscal deficit target of 5.0% of GDP over 2022-2024 under the Medium Term Fiscal Framework (MTFF),** implying budget deficit is estimated to average RM82.5bn a year over 2023-2024 **based on an average crude oil assumption of US$67/ barrel (2022: $66/ barrel and 2021e: $68/barrel).** This also implies that the fiscal deficit target of 3.0-3.5% of GDP by end-2025 under the 12th Malaysia Plan may remain a tall order, as per our commentary dated 27 September.

Key Take-away from the 2022 Budget

- The headline 2021 budget allocation totalled RM322.5bn and is now revised lower to RM320.6bn due to some recalibrations. The government said that some RM23.9b savings were generated from the deferment/delay of projects and programmes, of which RM22b was redirected to the Covid-19 Fund. The net reduction stood at RM1.9b. Nonetheless, this is still higher than the total spending of RM314b in 2020. The government attributed this to a series of four stimulus packages announced throughout the year which involved a total of RM25b fiscal injection.

- The 2022 budget allocation stands at RM332.1bn (20.3% of GDP), 3.5% higher than the revised expenditure as mentioned above. Operating expenditure (OE) is budgeted at RM233.5bn (14.3% of GDP), up by 6.3% from 2021. This is attributed to the annual salary increment for civil servants as well as higher retirement charges resulting partially from higher number of retirees. Debt services charges are also estimated higher at RM43.1bn in 2022 (2021e: RM39.0bn).

- Development expenditure (DE) is raised to RM75.6bn, up from RM62.0bn in 2021, marking its second year of increase. The economic sector receives RM40.2b, with focus on projects related to transport, trade, industry and industry, energy and public utilities. Bulk of the allocation goes to transports (20.5%) although its share had gotten significantly lower throughout the years.

Figure 6: Expenditures to increase across the board

	2022	2021 revised	2021 original
OPEX (RMbn)	**233.5**	**219.6**	**236.5**
OPEX (% of total)	70.3	68.5	73.3
DE (RMbn)	**75.6**	**62.0**	**69.0**
DE (% of total)	22.8	19.3	21.3
Covid-19 Fund (RMbn)	**23.0**	**39.0**	**17.0**
Covid-19 Fund (% of total)	6.9	12.1	5.2
Total	**332.1**	**320.6**	**322.5**

Source: MOF 2022 Fiscal Outlook

Notably within the social sector, education and training are set to receive nearly RM12b or 15.8% of total DE. This represents a whopping 47.2% mark-up compared to 2021.

- On the other hand, the federal government revenue is projected at RM234.0bn, up 5.9% from the revised RM221.0b in 2021. The government expects all revenue sources to climb next year amid better economic prospects.

- Tax collection is estimated to increase to RM171.4bn, from RM161.8bn estimated in 2021. Within the direct tax segment, corporate income tax which made up the largest share of total revenue is expected to increase by 8.1%, individual income tax to grow 3.0% while petroleum income tax to increase by 7.8%.

- Meanwhile, non-tax revenue is expected to rise 5.8% to RM62.6bn due to higher proceeds from investment income. Petroleum related revenue is projected to increase to RM 43.9b (18.8% of total revenue). This is lower than the estimated 19.2% share in 2021 and 24.9% in 2020.

- Here is the Budget Touchpoints by MOF for greater details on the budget measures.

Implications on USDMYR outlook

- USD/MYR finally nudged below 4.14 post-budget announcement, after clinging on to a tight range of 4.14-4.15 throughout the week. We expect the pair to continue range-trade in a holiday-shortened week ahead within 4.13-4.17, on expectations that BNM will deliver a neutral rhetoric next Wednesday following's today's positive vibes of an expansionary budget to revitalize growth.

- Looking ahead, the divergence in policy tightening/normalisation pace by global central banks are expected to drive directions in the FX space. More hawkish central banks such as the RBNZ and BOC are expected to move more aggressively compared to the more accommodative Federal Reserves, whereas the ECB and BOJ are set to remain relatively dovish. Against this background, we see only a modest strengthening of the USD and expect the MYR to fare relatively well compared to its Asian counterparts. We attribute the resilience in MYR to further economic recovery in Malaysia following the relaxation of restrictions, accompanied by the eagerness of vaccinated Malaysians to return to normalcy.

- In view of this, we project MYR to stay well-supported around 4.15 through the most part of 2022 before strengthening to 4.10 against the USD by end-2022. We maintain our base case that BNM may normalise rates early 2023 but do not discount the possibility of an earlier move in the 2H of 2022 provided that the pace of recovery beats expectations. This may offer another positive boost to the MYR.

Implications on MYR bonds market

- An earlier revision of total gross MGS/GII issuances for 2021 from RM152.5bn to RM160.5bn was carried out on the 1st October for which RM140.0bn has

Figure 7: Direct tax collections to increase amid improving economic prospect

	2022	2021 revised	Changes (y/y)
CITA (RMbn)	65.5	60.6	+8.1%
CITA (% of total revenue)	28.0%	27.4%	
Individual (RMbn)	37.5	36.4	+3.0%
Individual (% of total revenue)	16.0%	16.5%	
PITA (RMbn)	12.4	11.5	+7.8%
PITA (% of total revenue)	5.3%	5.2%	

Source: MOF 2022 Fiscal Outlook

been successfully conducted at the time of writing**. Hence, we expect another RM20.5bn for the remaining five (5) auctions for 2021 consisting of RM13.0bn MGS bonds and RM7.5bn of GII Sukuk.**

- **For 2022, we expect a sustained gross MGS/GII supply of circa RM167.0bn** (net of SPK maturity switch to GG issuances); amid higher MGS/GII/SPK maturities worth circa RM78.2bn. Net supply however is expected to increase slightly from RM86.8bn to RM88.5bn.

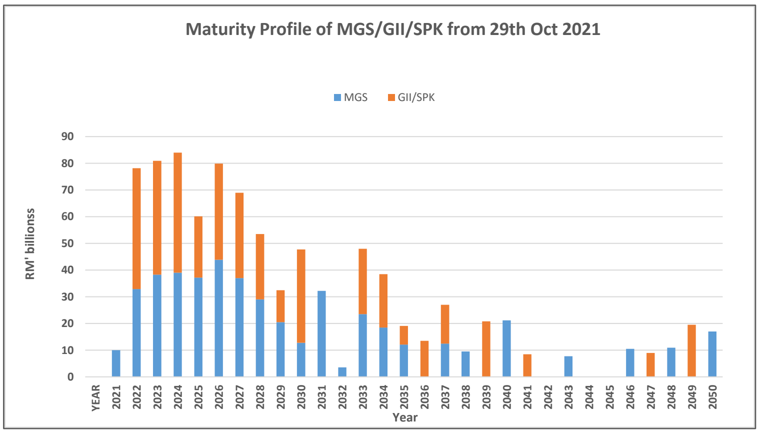
RM (Billion)	2020	2021e	2022f
MGS/GII Maturities	73.4	73.7	78.2
Federal Govt deficit	87.6	98.8	97.5
Net Govt Bond Supply (MGS/GII)	75.4	86.8	88.5
Projected SPK switch	-	6.0	9.0
1MDB cash proceeds	10.0	-	-
PETRONAS special dividend	-	7.0	-
Gross Supply (MGS+ GII only)	**148.8**	**160.5**	**166.7**

Source: MOF Fiscal Outlook Report 2022; BPAM, HLBB Global Markets Research

- Federal Government's **funding needs of RM166.7bn for 2022 is expected to be funded onshore up by both MGS/GII.** This is partly due to the possibility of unavailable limits under the self-imposed rule of RM35b FCY debt by the government arising from the recent rollover of USD800m maturity in July with a successful issuance of USD1.2b instead. Any shortfall may be met by "special receipts" from PETRONAS, pending asset disposals pertaining to 1MDB and also by other instruments such as Bills. On a separate note, very little information is provided about the proposed sustainability sukuk amounting to RM10b. Hence, we have not factored that into the abovementioned projection for gross issuances as of now.

- **We expect MGS/GII issuances for 2022 to be distributed in a ratio of about 55:45 and skew towards the short end 3Y, medium-term 10Y and also longer end of the curve, the 20Y tenures;** taking into cognizance the high level of maturities from 2022-2031. Much of the anticipated issuances may hinge on a combination of 10Y-20Y tenures. We project a busy issuance period beginning 1Q22 to reduce the impact of outflows taking into account circa RM18.0b of maturities.

- **Going into 2022, based on scheduled MGS/GII maturities, there are sizeable maturity windows in both 1Q2022 and 3Q2022.** Maturities are seen maxing out in 3Q2022; forming the bulk ~52% of total. Despite the investment grade ratings accorded by international rating agencies Moody's and S&P coupled with comparatively attractive yields for MYR govvies; expect challenges ahead in the face of rising global yields. This may however be mitigated by the remarkably well-diversified, depth and breadth of investment institutions, which are expected to provide strong institutional support and appetite within the govvies space. We expect reinvestments to be ploughed back into the govvies space from maturing MGS/GII.



Source: BPAM/ Bloomberg, HLBB Global Markets Research

Quarter	2022	Stock	Monthly Maturity (RM'm)	Quarterly Maturity (RM'm)
	JAN			
1	FEB			
	MAR	MGS 3/22 & GII 3/22	11,400 & 6,800	18,200
	APR	GII 4/22	11,000	
2	MAY			
	JUN			11,000
	JUL	SPK 7/22 & GII 7/22	9,000 + 10,000	
3	AUG	MGS 8/22	10,500	
	SEP	MGS 9/22	11,000	40,500
	OCT			
4	NOV	GII 11/22	8,500	
	DEC			8,500
	Total		78,200	78,200

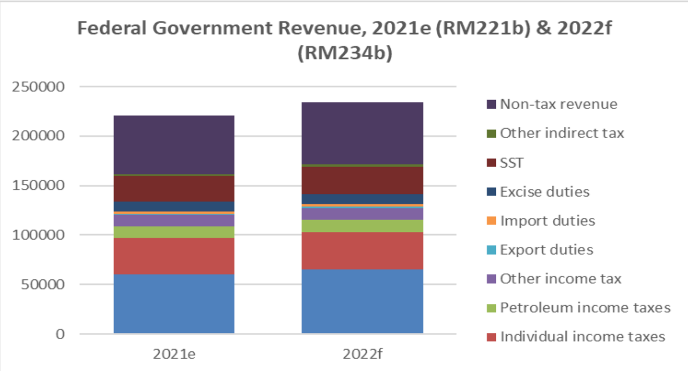
Source: BPAM/ Bloomberg, HLBB Global Markets Research

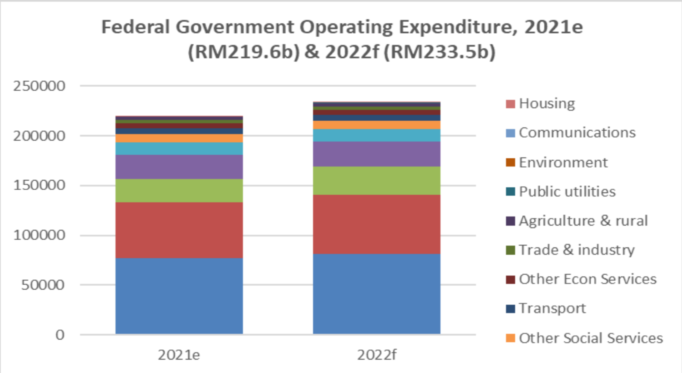
Federal Government Finance (RM million)

	2017	2018	2019	2020	2021③	2022 ④
Revenue	220,406	232,882	264,415	225,076	221,023	234,011
% change	3.8	5.7	13.5	-14.9	-1.8	5.9
Operating Expenditure	217,695	230,960	263,343	224,600	219,600	233,500
% change	3.6	6.1	14.0	-14.7	-2.2	6.3
Current Surplus/Deficit	2,711	1,922	1072	476	1,423	511
Gross Development Expenditure	44,884	56,095	54,173	51,360	62,000	75,600
% change	6.9	25.0	-3.4	-5.2	20.7	21.9
Direct Expenditure	42,277	54,405	52,058	49,331	60,814	73,617
% change	5.6	28.7	-4.3	-5.2	22.2	22.6
Gross Lending	2,607	1,690	2,115	2,029	1,186	1,983
Minus Loan Recoveries	1,852	788	1,603	1,259	800	600
Net Development Expenditure	43,032	55,307	52,570	50,101	61,200	75,000
% Change	5.9	28.5	-4.9	-4.7	22.2	22.5
Covid-19 Specific Fund	-	-	-	38,019	39,000	23,000
Overall deficit	**-40,321**	**-53,385**	**-51,498**	**-87,644**	**-98,777**	**-97,489**
% of GDP	**-3.0**	**-3.7**	**-3.4**	**-6.2**	**-6.5**	**-6.0**
Primary deficit	-12,458	-22,838	-18.565	-53,149	-59,777	-54,389
% of GDP	-0.9	-1.6	-1.2	-3.8	-3.9	-3.3
Sources of Finance						
Net External Borrowing	-342	-320	6,977	-331	1,601	-
Net Domestic Borrowing	40,750	54,427	44,755	86,921	98,800	-
Change in assets②	-87	-722	-234	1,054	-1,624	-

Note: ② Indicates a draw down of assets; ③ Revised estimate; ④Budget estimate

Source: MOF Fiscal Outlook 2022





Source: MOF Fiscal Outlook 2022

Balance of Payments (RM Billion)

	2017	2018	2019	2020e	2021e	2022f
Balance on Goods	116.78	114.62	124.74	138.71	170.39	178.93
Balance on Services	-22.86	-17.52	-10.88	-47.45	-61.01	-57.65
Primary Income	-38.66	-45.08	-39.50	-23.58	-40.00	-54.37
Secondary Income	-17.30	-19.73	-21.45	-2.67	-12.72	-11.33
Balance on Current Account	**38.30**	**32.30**	**52.92**	**60.01**	**56.67**	**55.58**
Capital Account	-0.03	-0.09	0.37	-0.43	-	-
Financial Account	-4.73	11.43	-38.02	-76.16	-	-
Direct Investment	*16.17*	*10.10*	*6.56*	*2.76*	-	-
Portfolio Investment	*40.41*	*-49.40*	*-31.15*	*-48.20*	-	-
Financial derivatives	*-0.20*	*0.98*	*-0.48*	*0.41*	-	-
Other Investment	*-5.35*	*49.74*	*-11.70*	*-31.12*	-	-
Errors & Omissions	-17.13	-35.88	-6.85	-2.72	-	-
Overall Balance	16.41	7.76	8.42	-19.30	-	-

Source: MOF Economic Outlook 2022

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