ASIA

Malaysia’s 2020 Budget: A Delicate Balancing Act

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Malaysia’s newly unveiled 2020 budget displays a commitment to sustainable long-term growth, according to Sukumar Rajah and Hanifah Hashim. Here, they suggest how the country’s foreign investment, transport and employment initiatives could drive the domestic economy.

We regard Malaysia’s 2020 budget as a balancing act between narrowing the country’s fiscal deficit and avoiding an economic slowdown.

Finance Minister Lim Guan Eng announced a moderately expansionary budget in support of growth-led initiatives.

Overall, we think the budget demonstrates a commitment to bring down the fiscal deficit and move toward sustained economic growth. This includes incorporating growth-oriented initiatives to fund transport infrastructure, tax breaks for the electronics industry and incentives to boost female participation in the workforce.

Focus Falls onto the Domestic Economy

We view Malaysia’s announced budget measures as supportive of the domestic economy. The measures focus on improving private investment by attracting higher value-added activities and promoting a productive economy through digital initiatives.

Innovative employment initiatives such as “Malaysians@Work” should provide employment opportunities for Malaysians, while reducing the dependency on imported labor. The government introduced the Malaysians@Work program to reduce the country’s overall unemployment rate. It includes hiring and tax incentives for employers, and focuses on improving working conditions and training for employees as well as creating employment opportunities for youth and women in particular.

We think companies in Malaysia would benefit from a more skilled and motivated workforce, and in turn, should likely translate into improved stock-price performance over the longer term.

Females in the Workforce Could Unlock Malaysia’s Full Economic Potential

A World Bank study said that if Malaysia removed all barriers to work for women, female participation in the economy would increase the country’s income per capita by 26.2%.[1]

The global organization reported in 2018 that 80.4% of working-age men were participating in the labor market, but only 55.2% of women were—lower than some other countries in the region.

To ensure equal access to productive jobs, the report recommended policies that would facilitate economic opportunities for women. These include expanding the availability, quality and affordability of child and elderly care, strengthening informal workers’ rights and addressing gender attitudes in education.

Despite these positive domestic developments, external headwinds such as subdued global economic growth, uncertainty over the outcome of US-China trade negotiations and other geopolitical events may continue to weigh on the market in the near term.

Sectors in Focus

The new budget could bring positive impacts on sectors such as construction and tourism due to the continuation of stimulus measures and the increased number of “Visit Malaysia Year 2020” initiatives to drive tourism.

Meanwhile, we’d expect the property sector, such as housebuilders and developers, to reap likely eventual benefits from measures that address the oversupply of unsold properties, such as lowering the foreign ownership threshold for high-rise property and the Rent-to-Own (RTO) program.

Other beneficiaries include the technology sector (such as manufacturers of electrical and electrical components), which will benefit from the introduction of a 10-year tax break on high value-added activities. To qualify for the new tax break, companies must invest at least 5 billion Malaysian ringgits to support small and medium enterprises (SMEs), and create 150,000 high-quality jobs over the next five years.

Earlier this month, one of Malaysia’s largest mobile network operators also partnered with China’s Huawei to launch a fifth-generation (5G) telecommunications network once the technology becomes available. We think this collaboration could be one of the drivers of transformation for the technology sector, in addition to industries such as manufacturing, agriculture and health care, to become global competitors.

Separately, the consumer sector is also likely to benefit from the continuation of financial aid and social assistance, which is more refined and measured in approach to targeting specific households.

Budget 2020 Developments

- Ten-year income tax exemption for electronics companies that will play a part in the economy’s general transition to a 5G digital economy.
- Repair and maintain all roads to Port Klang, the world’s 12th busiest container port. This includes a dedicated privatized highway between Northport and Westport, both large harbors in the dedicated port town.
- Dedicate 500 million Malaysian ringgits (US$120 million) to electricity projects and a further 587 million Malaysian ringgits (US$140 million) to water projects in rural areas.
- Increase female participation in the labor force to 60% through a wage incentive of 500 Malaysian ringgits (US$120) a month for two years, in addition to paying employers 300 Malaysian ringgits (US$72) a month to hire them.
- Employers who hire graduates who have previously been unemployed for more than a year will receive 300 Malaysian ringgits per month for two years, through the Malaysians@Work initiative.
- Lower the minimum price of high-rise urban properties available to foreigners from 1 million Malaysian ringgits to 600,000 Malaysian ringgits (US$143,000).
- Establish a Rent-to-Own financing scheme for low-income individuals to open-up access to property finance.
- Introduce a digital-services tax for e-commerce companies, online platforms, mobile applications and advertising.

Looking Ahead

External headwinds such as subdued global economic growth, uncertainty over the ongoing US-China trade war and geopolitical uncertainties, may continue to weigh on markets in the near term.

From our observations, Malaysia's bond market had largely priced in the higher fiscal target deficit of 3.2% announced in the budget. Investors also seem to be pricing in another 25 basis point (bps) interest rate cut before the first quarter of 2020, in response to perceived sluggish growth arising from external headwinds.

However, the latest economic projections unveiled in the budget throw those expectations into doubt, in our view. We feel the higher inflation rate target of 2% and higher gross domestic product growth target of 4.8% lowers the probability of another rate cut in the short term.

To conclude, we think the government's move to target strategic points within the economy is largely positive towards the country's long-term potential. As the government moves to attract more foreign investment after a positive first half of 2019, the government's fiscal discipline should also provide flexibility in case of any future economic challenges, in our view.

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Investments in foreign securities involve special risks including currency fluctuations, economic instability and political developments. Investments in emerging markets, of which frontier markets are a subset, involve heightened risks related to the same factors, in addition to those associated with these markets' smaller size, lesser liquidity and lack of established legal, political, business and social frameworks to support securities markets. Because these frameworks are typically even less developed in frontier markets, as well as various factors including the increased potential for extreme price volatility, illiquidity, trade barriers and exchange controls, the risks associated with emerging markets are magnified in frontier markets. Investments in fast-growing industries like the technology sector (which historically has been volatile) could result in increased price fluctuation, especially over the short term, due to the rapid pace of product change and development and changes in government regulation of companies emphasizing scientific or technological advancement.

1. Source: World Bank, “Breaking Barriers, Toward Better Economic Opportunities for Women in Malaysia,” September 2019.