

# Country Analyst

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## Malaysia 2010 Budget: Narrower Fiscal Deficit

The Malaysian government announced a less expansionary-than-expected budget for 2010 with the budget deficit expected to narrow sharply to around 5.6% of GDP next year from an estimated 7.4% in 2009 (down slightly from its original target of 7.6%). The deficit target for 2010 is sharply lower than our initial forecast of 7% of GDP. This was based on assumption of 13.7% cut in operating expenditure and a smaller 4.4% cut in development expenditure while revenue is expected to drop by 8.4% in 2010. In line with our expectation, the government has announced 14.7% cut in subsidies in 2010. It will also implement a fuel subsidy management system early next year to ensure the benefits accrue to targeted groups.

The narrower-than-expected fiscal deficit hinted at the government's concerns over the sustainability of large spending plans and a redirection of its focus back towards fiscal consolidation as the economy turns around next year. We could see the government pushing for the budget deficit to return to pre-crisis levels of under 5% of GDP (between 2004 to 2008) in the coming 2-3 years. Second Fin Min Ahmad Husni said the government plans to balance the budget in 3-6 years. However, it remains to be seen whether the deficit of 5.6% of GDP can be achieved next year given the personal income tax cut and increased allocation of funds for civil servants' salaries. This represents around 20.8% cut in the budget deficit to RM40.48bn in 2010 from an estimated RM51.115bn this year.

### Budget Highlights

#### Tax measures:

##### 1) Cut in personal income tax rate

The highlight of the budget was the surprise 1 ppt cut in the top personal income tax rate to 26% for YA2010. We have expected no change in the personal income tax rate in 2010 after it was just reduced by 1 ppt to 27% in 2009, given consideration for the high budget deficit in the country. In the longer-term, the continued review of the income tax rates in the country will help to make it more competitive to foreign corporates and talents. Income tax on employment income of Malaysians and foreign knowledge workers (in some highlighted sectors) in Iskandar Malaysia will be at a lower 15% indefinitely if they commence work before end-2015. This will be helpful in promoting the Iskandar Development Region. To help the Malaysians cope with slower growth, the government has also increased the personal tax relief from RM8,000 to RM9,000 in YA2010.

##### 2) Imposing 5% property gains tax

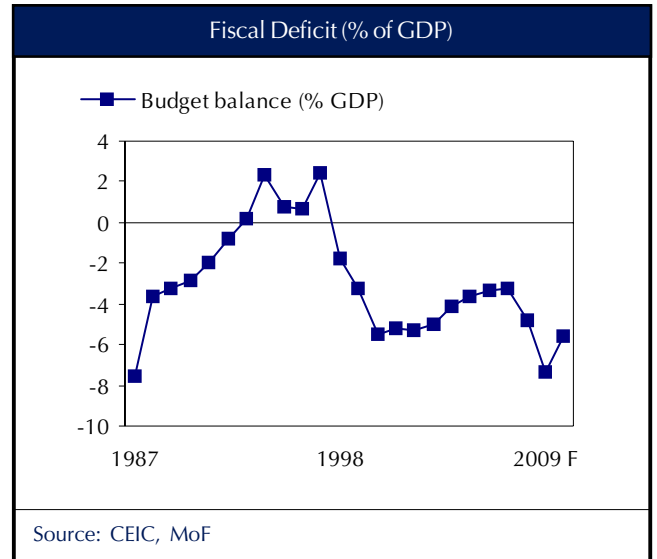
The government has proposed to tax gains from the disposal of real property at 5% from 1 January 2010. This could have a deterrent effect on excessive real estate speculation.

##### 3) Still studying GST

In line with our expectation, the Malaysian government did not rush into the implementation of the Goods and Services Tax (GST) in this Budget. PM Najib said the government is still studying the tax which if implemented will replace the current sales tax and service tax. Besides considering to exempt the low income group from the GST, the government also said the potential GST rate will be lower than current sales tax and service tax rates.

### Investment and Privatisation

One of the three Budget strategies is to drive the nation towards high-income economy. To achieve that, the government has announced measures to boost investment in the country which was on top of the agenda for PM Najib. The government will intensify efforts to attract FDI by allowing equity ownership in companies and joint ventures in local projects. There are also plans to accelerate the privatization of companies under the Ministry of Finance and other viable government agencies in Malaysia.



### Boosting SME Development

Besides simplifying SME financing, the government said it will allocate RM350mn to SME Corp, of which RM200mn will be used for SME soft loans. It will also allocate RM538mn for the implementation of various SME development programmes in the country. We see this a positive initiative for strengthening the SMEs in the country which bore the brunt of the economic slowdown this year.

### Financial Industry Initiatives

Some of the key initiatives for the financial industry include the liberalization of the commission-sharing arrangements between stockbrokers and remisiers and the increase of the foreign equity participation in corporate finance and financial planning companies to 100% from 30% currently. To boost Islamic finance in Malaysia, the government has also extended the existing tax incentives for the industry to 2015. Furthermore, the government will extend the scope of the incentives to include stamp duty exemption of 20% on Islamic financing instruments and exempt tax on banking profits derived from overseas operations amongst others.

### Restoring EPF Contribution Rates

With the economic recovery, the government will allow employees' EPF contribution rate to be restored to 11% on a voluntary basis with immediate effect. Full restoration to 11% will be required by 1 Jan 2011.

### Revising up the Official Growth Forecast

The Malaysian government now expects the full-year GDP contraction to be 3%, improving from -4% to -5% previously. This was assuming 12.1% contraction in the manufacturing sector and growth of 2.1% in services and 3.5% in construction. The government's growth forecast for 2009 is in line with our forecast for 2009 but for 2010, we are expecting 4.9% GDP expansion which is much stronger than the government's forecast of 2%-3% growth.

## **Highlights of Budget 2009:**

- RM6bil for agriculture sector for paddy fields irrigation, fish production, fruit farming, livestock farming infrastructure, training
- RM2bil subsidy for farmers and fishermen including subsidies for fertilisers, incentives for padi yields and allowances for fishermen
- RM9bil to finance infrastructure projects including road and bridges projects and rail, sea ports and airports facilities
- RM1.5bil fund to promote green technology by providing soft loans to companies that supply and use green technology
- RM200mil Creative Industry Fund to finance film, drama, music productions, animation, advertisements through Bank Simpanan Nasional
- In a bid to develop high quality human quality, RM30bil will be allocated to enhance primary and secondary education nationwide
- Taxpayers will get tax relief on broadband subscription fee of up to RM500 from 2010 to 2012. Civil servants can apply for computer loans up to a maximum of RM5,000 from the govt once in every 5 years.
- Allow 100% foreign equity participation in corporate finance and financial planning companies compared with the present requirement of at least 30% local shareholding.
- To ensure rapid development of financial services, the existing tax incentives to be extended to 2015.
- Tax of 5% to be imposed on gains from the disposal of real property from Jan 1, 2010. Existing tax exemption will be retained for gifts between parent-child, husband-wife, grandparent-grandchild.
- To promote prudent spending, a service charge of RM50 a year to be imposed on each principal credit card and charge card; and RM25 a year on each supplementary card, effective from Jan 1, 2010.
- To ensure that fuel subsidies only benefit targeted groups, Govt will implement a fuel subsidy management system in early 2010, which will utilise the MyKad.
- All Ministries and govt departments are required to provide day care and education centres for children of civil servants.
- The maximum income tax rate for individuals to be reduced to 26% from assessment year 2010. Personal relief increased to RM9,000.
- Police force to get RM1bil to improve its services in govt's efforts to reduce crime. Major measures include to increase police presence, including mobile police stations in 50 crime hotspots.
- To promote house ownership, Govt will launch a scheme that enables EPF contributors to utilise current and future savings in Account 2.
- Employees' EPF contribution to be increased to 11% again, on a voluntary basis, effective immediately. However, from Jan 1, 2011 employees' EPF contribution will revert to 11%.
- Personal relief for EPF and life insurance schemes to be increased to RM7,000.

Source: Newswires