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Malaysia: Firm 2Q08 GDP Growth; Budget 2009 More Expansionary Than Expected

Malaysia's 2Q08 GDP growth came in within our expectation at 6.3%/y/y (1Q08: 7.1%) although this was higher than consensus expectation of 5.9%. Private consumption and fixed investment remained firm while export growth strengthened in 2Q08. Electrical and electronics exports rebounded and the double-digit expansion in shipments of oil and oil-related products drove the robust export performance in the quarter.

The government is expecting full-year growth of 5.7% this year, with the growth rate slowing to 4.8%/y/y in 2H08 from 6.7% in 1H08. Economic growth in Malaysia is projected to slow further to 5.4% in 2009. Nonetheless, the government is expecting the global economy to stabilise and begin its recovery in 2H09. The resilient economies in Asia and other emerging markets are expected to cushion the slowdown in the developed markets, helping to keep exports supported. Domestically, firm commodity prices and higher government spending should mitigate the negative impact of higher food and fuel prices. Overall, we are expecting a lower 5.2% growth rate for 2008 and our growth forecast for 2009 is also less optimistic at 4.6% as we see greater risk in the global environment.

A Caring Government

The focus of Budget 2009 is on strengthening the social safety net and helping the poor cope with higher cost of living. Measures include raising the personal income tax rebates for taxpayers with annual income of RM35,000 or lower and defraying electricity bills for households which incur monthly electricity bills of RM20 or less, for October 2008 to end-2009. As promised, the government also announced proposals to boost the food production and the transport network in Malaysia. However, there was no significant broad measure for the corporates although targeted areas such as Islamic financing and REIT investment received some incentives. There were also accelerated capital allowance for the SMEs to encourage investments amid the more challenging economic environment.

Top Personal Income Tax Rate Reduced by 1 Percentage Point

The highlight in the Budget was probably the 1 percentage point cut in the top income tax rate by 1 ppt to 27% in 2009 from current 28%, closing the gap with the corporate income tax rate which would fall to 25% next year. For taxpayers earning RM35,000 per year or lower, the personal income tax rebate will be increased to RM400 from RM350. There are

2Q08 GDP: Exports Strengthened While Private Consumption and GFCF Remained Firm					
	2007	3Q07	4Q07	1Q08	2Q08
	y/y % change				
GDP	6.3	6.7	7.3	7.1	6.3
Consumption					
Public	6.6	6.0	4.2	10.5	7.1
Private	10.8	13.0	10.2	11.7	9.0
GFCF	9.6	12.8	10.2	6.0	5.6
Change in Stocks (as % of GDP)	-1.2	-3.3	-4.1	-2.3	-2.2
Exports	4.2	2.9	7.8	6.0	9.7
Imports	5.4	3.1	11.0	3.4	8.4
Source: Department of Statistics, Malaysia					

also tax exemptions to employees for staff benefits such as interest subsidies on housing, motor vehicles and education loans up to total loans of RM300,000 as well as childcare allowances.

For the corporates, new tax exemptions include travel allowance given to employees, the extension of tax exemptions on medical benefits to maternity expenses and traditional medicine. No further tax cuts are announced given that the government has already reduced its top corporate tax rate by 3ppt to 25% for 2009 from 28% in 2006.

The tax exemptions and cut in the personal income tax rates were anticipated measures although there were some concerns over the government's budget deficit constraints. However, the cut in the EPF contribution rates did not materialise. Overall, there were few surprises in the Budget.

Budget Deficit for 2008 Surged to 4.8% of GDP

The government expects the budget deficit to increase to 4.8% of GDP this year (largest since 5.0% in 2003) from 3.2% in 2007, largely due to a sharp jump in the operating expenditure which will be in turn the result of higher cost of fuel subsidies, higher expenditure on social assistance programmes and new spending on food security programmes. The government had previously targeted to reduce this to 3.1% of GDP this year. Nonetheless, the budget deficit is expected to narrow to 3.6% of GDP next year as the government refocuses on its fiscal consolidation goal. As a result, we do not foresee too much concern over the sharp increase in the budget deficit this year.

Highlights of Budget 2009:

- Top personal marginal tax rates to be cut to 27% in 2009 from current 28%.
- The Government will provide a bonus of one-month salary, subject to a minimum of RM1,000 for 2008 for civil servants. The bonus will be paid in two instalments, in September and December 2008.
- The eligibility criteria for welfare assistance under the Welfare Department has been raised from a monthly household income of RM400 to RM720 for Peninsular Malaysia, RM830 for Sarawak and RM960 for Sabah.
- Government pensioners who had served at least 25 years upon retirement, will receive a pension of not less than RM720 per month, effective 1 January 2009.
- Households which incur monthly electricity bills of RM20 or less, will not have to pay for electricity, for the period 1 October 2008 to end-2009.
- The current tax rebate of RM350 per person will be increased to RM400 for those with taxable income of RM35,000 and below.
- All interest income for individuals will be tax exempt.
- Import duties on various consumer durables will be halved to between 5%-30% from between 10%-60%.
- Road tax on private passenger vehicles with diesel engines will be reduced to same level as those with petrol engines, effective 1 September 2008.
- Travel allowance for commuting to work provided by employers will be given full tax deduction, while the employees receiving such an allowance be given tax exemption of up to RM2,400 per year.
- Tax exemption will be given to employees on the following staff benefits including interest subsidies on housing, motor vehicles and education loans up to total loans of RM300,000, mobile phones, as well as telephone and internet bills paid by the employer, childcare allowance of up to RM2,400 per year etc.
- Tax exemption on medical benefits provided by employers will be extended to maternity expenses and traditional medicine.
- RM35 billion will be expended between 2009-2014 to improve the efficiency of public transportation.
- To reduce the operating costs of public transport operators, the government will provide a soft loan facility of RM3 billion under the Public Transportation Fund and reduce toll charges by 50% for all buses, except at border entry points.
- A sum of RM5.6 billion is provided under the National Food Security Policy for 2008-2010 in order to incentivise agriculture entrepreneurs to reduce production costs and encourage higher agriculture output. The government also announces RM300 mn to increase fish landings and boost poultry output with Reinvestment Allowance of 60% for 15 years.
- To encourage home ownership among civil servants, the Government will improve the terms for staff housing loans, by extending the tenure of new housing loans from 25 years to 30 years, provide housing loan facility for renovation works on houses not purchased through Government housing loan; and extend the housing loan insurance panel to all eligible insurance companies.
- For the purchase of medium cost houses of up to RM250,000, a 50% stamp duty exemption is given only on the instrument of transfer. To further reduce the cost of buying medium cost houses, the Government proposes the 50% stamp duty exemption be extended to loan agreements.
- RM2.4 billion is allocated to enhance facilities as well as undertake training and skills programmes. Of this, a sum of RM150 million is to upgrade 13 existing polytechnics as well as 15 community colleges and their branches.

- To further promote private sector investment, the government proposes that the tax treatment on group relief be enhanced by allowing losses for the purpose of offsetting be increased from 50% to 70%.
- In the Midterm Review of the 9MP, an additional ceiling of RM10 billion has been allocated for the development expenditure of the corridors, of which RM6 billion is provided in the 2009 Budget.
- To further strengthen private investment in Iskandar Malaysia, an additional allocation of RM300 million is provided under the Strategic Investment Fund.
- In the context of the corridor development in Sabah and Sarawak, the government proposes that new investments by 4-star and 5-star hotel operators in Sabah and Sarawak be given Pioneer Status with 100% income tax exemption or Investment Tax Allowance of 100% for 5 years.
- Venture capital companies that invest at least 30% of their funds in start-up, early stage financing or seed capital be eligible for a 5-year tax exemption.
- To support SMEs, the government proposes all assets in the form of plant and machinery acquired in the years of assessment 2009 and 2010 be given Accelerated Capital Allowance to be claimed within one year. In addition, SMEs are allowed to claim full Capital Allowance on all small value assets within one year.
- Tax exemption will be given on fees received by domestic intermediaries which successfully list foreign companies and foreign investment products in Bursa Malaysia.
- Tax exemption will be given for a period of three years for fees and profits earned by institutions undertaking activities relating to the arranging, underwriting, distributing and trading of non-ringgit sukuk issued in Malaysia and distributed outside Malaysia.
- The current tax rate on dividends received by foreign institutional investors from REITs will be reduced from 20% to 10%. For the individuals, the tax rate for REIT investment will also be reduced to 10% from 15%.

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