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Macro Note

Malaysia: Till Debt Do Us Part

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- Malaysia's debt woes have been a contentious issue ever since public officials said government debt totalled MYR1.09tr as at end-2018. This follows the government's decision to report the total debt and liabilities based on the amount borne by the government including the borrowings guaranteed and serviced by the government, projects under public private partnerships (PPPs), private finance initiatives (PFIs), PBLT Sdn Bhd[1], and liabilities on behalf of 1MDB.

- The debt breakdown as at end-2018 includes the official public debt (MYR741bn or 51.8% of GDP), liabilities that are guaranteed and borne by the government (MYR132.7.6bn or 9.3% of GDP), liabilities under PPPs, PFIs, and PBLT (MYR184.9bn or 12.9% of GDP), and 1MDB (MYR32.2bn or 2.3% of GDP).

- The government highlights four key ratios that will be monitored going forward: official public debt to GDP (51.2% at end-2018), overall debt and liabilities to GDP (75.4% at end-2018), fiscal deficit to GDP (estimate of 3.4% in 2019), and debt service ratio (13.1% at end-2018). The government will establish the Fiscal Responsibility Act to strengthen public finances, Debt Management Committee to focus on fiscal consolidation, reducing overall debt and liabilities of the government, and improving debt management.

- In addition, we think the government should establish guidelines on expenditure that are consistent with projected revenues and anchored to the debt thresholds. There should also be close monitoring of external debt through issuance of foreign currency bonds. Malaysia's adherence to the limits on external financing and ensuring that bulk of the country's borrowings remains funded in local currency is important for both debt management and credit risk.

Breakdown of Malaysia's Public Debt

There are variations to how public debt is measured and the most commonly cited is the general government debt or sum of liabilities of the central government. General government comprises federal government, state and local governments, and statutory bodies. The IMF's definition is broader as they take into consideration the consolidated public sector that includes the general government and nonfinancial public enterprises (NFPEs). Meanwhile sovereign rating agencies measure of government debt also considers officially reported committed government guarantees on loans which are serviced by the government as well as 1MDB's net debt.

The key risk to debt is sustainability and default risk particularly when domestic interest rates spike and growth weakens. The performance of the economy, quality of key institutions and assets held, political system, level of governance and transparency affects the country's sovereign risk and profile. After the new government took office in May 2018, a decision was made to report the country's total debt and liabilities based on the amount to be borne by the government including portions of borrowings guaranteed and serviced by the government, projects under PPPs, PFIs and PBLT, and liabilities on behalf of 1MDB. This resulted in a much higher official debt level of MYR1.09tr (75.4% GDP) as at end-2018, which some feared would impact Malaysia's sovereign credit ratings and outlook.

[1] PBLT is Pembinaan BLT Sdn Bhd, a company owned by the Ministry of Finance Incorporated (MKD) specialising in both public and private property and infrastructure facilities. PBLT was established in 2005 as the government's response to the 2004 Report of the Royal Commission to Enhance the Operation and Management of the Polis DiRaja Malaysia (PDRM).

On 17 July 2019, the Special Parliamentary Report Select Committee on the Budget highlighted in its report that the country's debt obligations would rise further amid persistent fiscal deficits coupled with other commitments including recovery of the Pilgrim's Fund (Lembaga Tabung Haji) via a special purpose vehicle which issued a MYR20bn Sukuk and restructuring of government agency FELDA that requires an injection of MYR6bn. The Committee also mentions that higher liabilities that are borne by the government will further accelerate the country's debt service ratio (currently at 13.1%) towards the self-imposed threshold of 15% of total federal government revenue or total operating expenditure.

1MDB Debt and Assets

1MDB's debt comprises of the principal value of the bonds and Sukuk issuance (MYR32.2bn) and interest (MYR11.4bn), as well as government injection (MYR8.1bn), bringing the total 1MDB debt to MYR51.7bn as at end-2018. 1MDB related assets including the Tun Razak Exchange, Bandar Malaysia, and Pulau Indah are valued at MYR10.1bn. As such, 1MDB's net liabilities are MYR41.6bn at end-2018 (1MDB debt: MYR51.7bn minus asset value: MYR10.1bn). The government highlights that 1MDB's asset sale and recovery process will be lengthy as majority of the assets are offshore including Singapore, Switzerland, and the United States. As at May 2019, the government managed to recover MYR918.92mn from abroad following sales of Park Lane Hotel and Equanimity superyacht. The government has filed a case over 1MDB's USD5.78bn IPIC deal in the London courts to recover USD1.46bn already paid and relieve Malaysia of any obligation to pay the balance.

Rating Agencies Reaffirm Malaysia's Credit Ratings, Cautions On Higher Debt

International rating agencies have reaffirmed Malaysia's "A- or A3 ratings" with a stable outlook. The stable outlook indicates that a change in the rating is less likely in the near-term. However, they caution that a sustained rise in debt and interest paid above certain threshold levels, and insufficient fiscal consolidation would put pressure on the country's credit ratings.

1) Fitch Ratings in their commentary dated 18 July 2019 highlighted that the greater clarity provided by the new Malaysian government on contingent liabilities does negatively influence the debt ratios. However, this is partly offset by the improved fiscal transparency. Significant asset sales could also result in a swifter decline in the debt stock. Fitch said the progress in implementing reforms that institutionalise improved governance standards through stronger checks and balances, greater transparency and accountability would strengthen Malaysia's business environment and credit profile. The debt figures used by Fitch include officially reported "committed government guarantees" on loans which are serviced by the government budget and 1MDB's net debt. Fitch Ratings cautions that limited progress in debt reduction due to insufficient fiscal consolidation or further crystallization of contingent liabilities could trigger a negative rating action.

2) Moody's acknowledged in its report dated 8 Jan 2019, that Malaysia's high debt burden is a significant constraint on the rating as Malaysia's government debt is above the median of 39.7% for A-rated sovereigns. Moody's estimates government debt based on direct debt obligations. While Moody's takes into account contingent liability risks posed by state-owned enterprises, Moody's deemed most of these entities to be in robust financial health and possess underlying assets. As such, this limits the risk to the government's balance sheet. Moody's stable outlook for Malaysia balances credit constraints from low debt affordability and a high debt burden against inherent credit strengths including Malaysia's resilient growth and a stable and broad funding base for the country's debt. While Moody's acknowledges the government's efforts to strengthen accountability and transparency, they expect these measures to materialise only slowly. Moody's cautioned that rising political tensions and divergences of views within the government that could undermine policy effectiveness which then impairs the government's capacity to adhere to fiscal consolidation and threatens the stability of capital flows could lead to a ratings downgrade.

3) S&P Global Ratings highlights in their assessment dated 3 July 2019 that the country's general indebtedness has risen relative to previous calculations owing to the inclusion of material contingent liabilities (including related with 1MDB). However, S&P expects the quantum of net debt to GDP to gradually decline over the next three to four years due to the government's more stringent management of debt accumulation and guarantee issuance. Should Malaysia's net general government debt and interest paid by the general government exceed certain threshold levels in a sustained way, this would put downward pressure on the country's credit ratings.

Policy Actions And Recommendations

Malaysia's high government debt levels need to be managed and restructured alongside fiscal consolidation. Even though there are variations in what constitutes the country's official public debt, we think any realisation of contingent liabilities or liabilities that require the government's support would intensify concerns about public debt and pressure up credit default swaps, domestic interest rates, aggravate capital outflows, and weaken the Ringgit.

The government highlights four key ratios that will be monitored going forward: 1) federal government debt–to-GDP (51.2% at end-2018), 2) overall debt and liabilities-to-GDP (75.4% at end-2018), 3) fiscal deficit-to-GDP (estimate of 3.4% in 2019 vs. 3.7% in 2018), and 4) debt service ratio (13.1% at end-2018).

There are some guidelines and statutory thresholds set for the federal government debt (limit at 55% of GDP), government external debt in foreign currency (limit at MYR35bn), issuance of short-term Treasury bills (limit at MYR10bn), and debt service ratio (limit at 15% of federal government revenue or total operating expenditure). There is no limit on the statutory guarantees. However, PM Tun Dr. Mahathir has mentioned that a limit should be imposed in view of the growing sum of government guaranteed debt.

Other initiatives such as the introduction of a Fiscal Responsibility Act and the Government Procurement Act will help enhance credibility and accountability of public finances. The government will publish details of the overall debt and liabilities (including government guaranteed and off-budget liabilities) in the annual fiscal report. The government has established a Debt Management Committee to focus on fiscal consolidation, reducing overall debt and liabilities of the government, and improving debt management. Some of the measures undertaken include evaluation of high-cost projects and identification of government guaranteed debt to be restructured. The Committee will also review acts, procedures and legal requirements relating to issuance of direct government debt, government guarantees and other government commitments.

In addition, we think that some guidelines on expenditure which are anchored to the debt thresholds should be established. Some flexibility can be allowed depending on the state of the economy and growth risks. The expenditure rules should be consistent with projected revenues. This will help enhance fiscal transparency and strengthen the credibility of the debt thresholds.

The government has a threshold of MYR35bn for government external debt in foreign currency. It has reached MYR28.5bn or 3.7% of total federal government debt as at 1Q 2019 (vs. MYR21.5bn or 2.9% as at end-2018). This includes the JPY200bn (or MYR7.4bn) samurai bonds issued this year. The bulk of Malaysia's government debt issued (or 96% of total) remains in domestic currency which is important as it lowers the risk and vulnerability to external shocks. Moody's mentioned that this is a key factor supporting Malaysia's high debt and broader credit profile. As such, Malaysia's adherence to the limits on external financing and ensuring that bulk of the country's borrowings remains funded in local currency is important for both debt management and credit risk. While the direct cost of borrowing from abroad may appear relatively low, the effective cost could be much higher after imputing the cost of hedging out currency risks.

Breakdown of Overall Government Debt and Liabilities

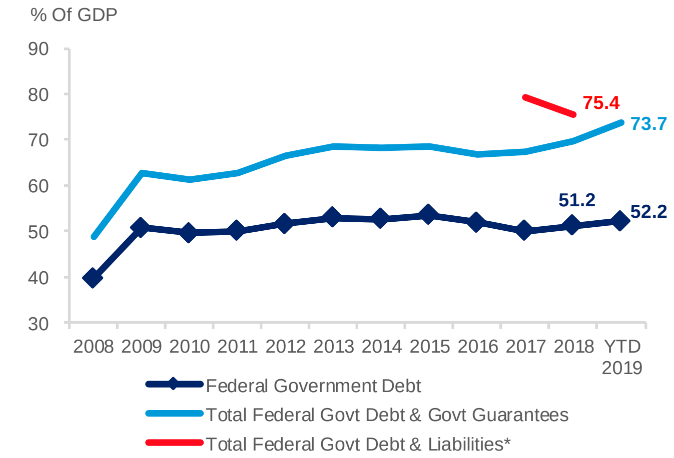
Source: 2018 Public Accounts Committee (PAC), UOB Global Economics & Markets Research

	MYR bn		% of GDP	
	End-2017	End-2018	End-2017	End-2018
Federal government debt	686.8	741.0	50.1	51.2
Government guarantees to be serviced	102.1	132.7	7.4	9.2
1MDB*	38.3	32.2	2.8	2.2
Other liabilities (PPPs, PFIs and PBLT)	260.1	184.9	19	12.8
	1,087.3	1,090.8	79.3	75.4

* Principal amount (excluding interest)

Historical Comparison Of Federal Government Debt And Liabilities

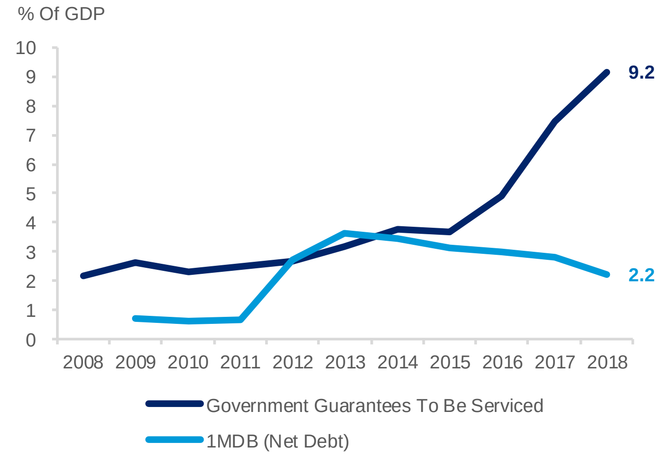
Source: 2018 PAC Report, Bloomberg, JANM Reports, UOB Global Economics & Markets Research



* Data for other liabilities (i.e. PPP, PFI and PBLT) are not available between 2008 and 2016.

Portion of Government Guaranteed Debt Serviced By Government Has Risen

Source: 2018 PAC Report, Bloomberg, JANM Reports, UOB Global Economics & Markets Research



Note: Data prior to 2017 are UOB's estimates based on the details in the 2018 PAC report and Bloomberg's numbers for 1MDB net debt.

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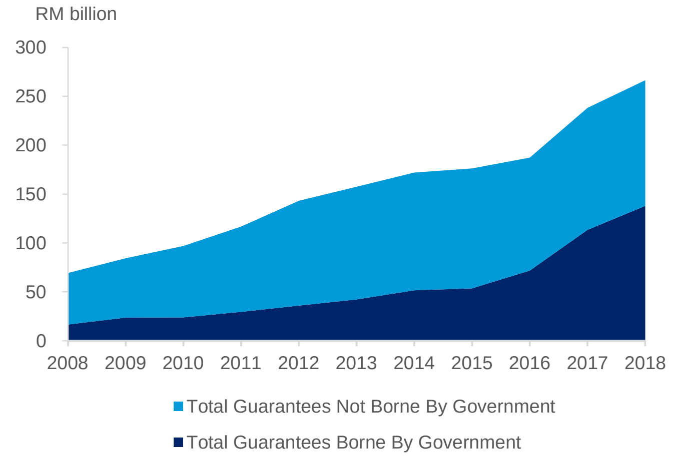
Government's Contingent Liabilities Amounted To MYR266.5bn In 2018, Of Which 49% Borne By Government

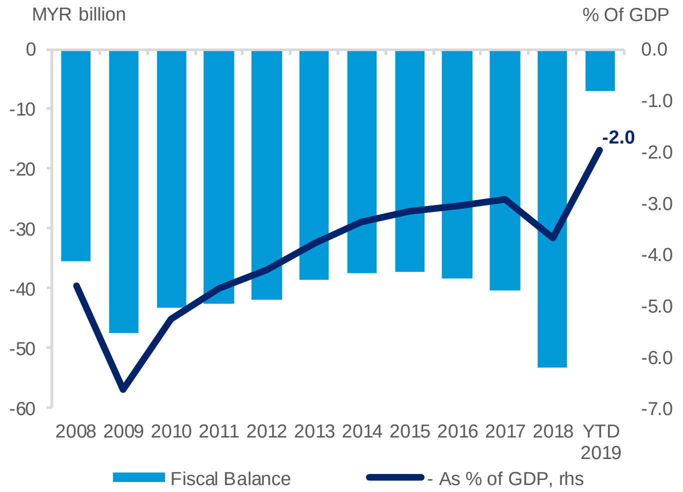
Source: 2018 PAC Report, JANM Reports, UOB Global Economics & Markets Research



Note: Data prior to 2017 are derived based on the list in the 2018 PAC report

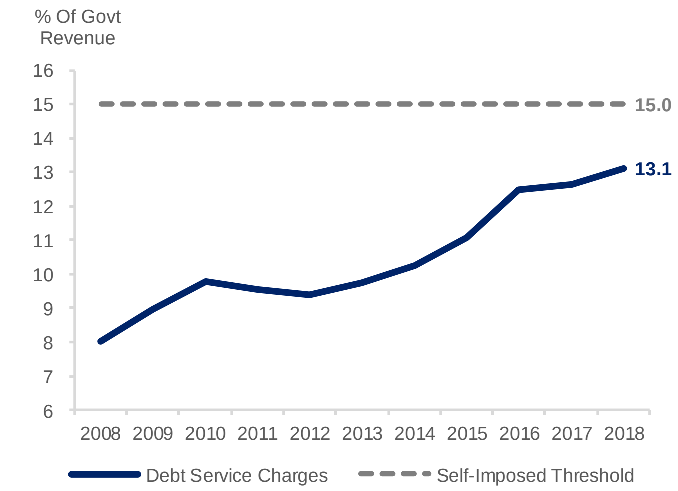
Budget Deficit Is Projected To Narrow To 3.4% of GDP In 2019 (from 3.7% in 2018)

Source: BNM, CEIC, UOB Global Economics & Markets Research



Debt Service Ratio Has Risen, Below Self-Imposed Ceiling Of 15% Of Government Revenue

Source: BNM, CEIC, UOB Global Economics & Markets Research



Malaysia's Current Self-Imposed Guidelines/ Thresholds For Government Debt

Source: 2018 PAC Report, UOB Global Economics & Markets Research

No.	Regulation	Statutory Limit	Administrative Limit	Current Status (end-2018)
1	Domestic debt ceiling (MGS, MGII, MITB)	≤ 55% of GDP		47.50%
2	External debt (in foreign currency) ceiling	≤ MYR35bn	55% of GDP	MYR21.5bn
3	Conventional treasury bill issuance	≤ MYR10bn		MYR4.5bn
4	Debt service charges limit	n.a.	≤ 15% of govt revenue or OPEX	13.1% of govt revenue
5	Contingent liabilities ceiling	n.a.	n.a.	MYR266.5bn

Comparison Of Countries' General Government Debt, 2017 vs. 2008, % of GDP

Source: IMF, UOB Global Economics & Markets Research

	2008	2017	Chg
China	27.0	47.0	20.0 ↑
India	74.5	71.2	-3.4↓
Indonesia	30.3	28.8	-1.5 ↓
Japan	183.4	237.6	54.2 ↑
Korea	28.2	39.5	11.4 ↑
Malaysia*	39.9	55.2	15.3↑
Philippines	52.1	39.9	-12.2 ↓
Thailand	34.9	41.9	6.9 ↑
Vietnam	39.4	58.5	19.1 ↑

* General government includes the federal government, state and local governments, and the statutory bodies

1MDB's Debt Breakdown, Estimated Asset Value And Recovered Monies

Source: 2018 PAC Report, Weekly Edge Malaysia, UOB Global Economics & Markets Research

1MDB DEBT BREAKDOWN (END-2018)	MATURITY	COUPON (%)	PRINCIPAL (RM BIL)	INTEREST (RM BIL)	TOTAL DEBT + INTEREST (RM BIL)	ISSUANCE ARRANGER
Sukuk (government-guaranteed)	2009-2039	5.75	5	5.894	10.894	AmInvestment Bank
1MDB Energy Ltd	2012-2022	5.99	7.3	1.536	8.836	Goldman Sachs
1MDB Energy (Langat)	2012-2022	5.75	7.3	1.474	8.774	Goldman Sachs
Global bond (with letter of support)	2013-2023	4.44	12.6	2.486	15.086	Goldman Sachs (received US$600mil /RM2.4 bil commission)
Total			**32.2**	**11.39**	**43.59**	
Note: Government also injected RM8.1 billion funds into 1MDB as at end-2018 (raising total exposure to RM51.7bil)					+8.1	additional cash injection by the government
					51.7	

1MDB ESTIMATED ASSET VALUE (END-2018)	RM BIL	NOTES
Tun Razak Exchange	1.8	Based on NTA in agreement between 1MDB and Aroma Teraju Sdn Bhd in June 2016
Bandar Malaysia	8	Based on net sale value (and value less sukuk Bandar Malaysia and minus airbase relocation cost) in agreement between TRX and Piramid Pertama Sdn Bhd on December 2015
Pulau Indah	0.277	Based on valuation done July 2017
Land in Ayer Itam, Penang	0	RM2.5 bil proceeds from land sale used to repay part of the settlement amount with IPIC
Total	**10.077**	

RECOVERED 1MDB MONIES (AS AT MAY 27, 2019)	RM MIL
1MDB recovery account [A]	30.3
MoF recovery account [B]	888.62
Total 1MDB monies recovered	**918.92**

Breakdown Of Government's Contingent Liabilities In 2017 and 2018

Source: 2018 PAC Report, Weekly Edge Malaysia, UOB Global Economics & Markets Research

	OUTSTANDING DEBT (RM BIL)		
	2017	2018	Y-O-Y CHANGE
Asset Global Network Sdn Bhd (MAS restructuring 2003/2013) (50:50 Government: Khazanah)^^	0.556	0.455	-0.101
DanaInfra Nasional Bhd (MRT and Pan Borneo Highway)	42.18	52.74	+10.56
Govco Holdings Bhd	8.8	7.3	-1.5
Jambatan Kedua Sdn Bhd (JKSB)	6.32	5.751	-0.567
KL International Airport Bhd (KLIAB)	0.18	0.094	-0.087
Malaysia Rail-Link Sdn Bhd (East Coast Rail Link/ECRL)	14.49	18.86	+4.37
Prasarana Malaysia Bhd (LRT/Rapid KL)	26.6	31.414	+4.8
Suria Strategic Energy Resources Sdn Bhd (Multi-Product Pipeline and Trans-Sabah Pipeline projects)	2.94	7.925	+4.98
MKD Kencana Sdn Bhd (takeover 51% stake in Northern Gateway Sdn Bhd's Kota Perdana project and 51% of Teon Choon Realty Co Sdn Bhd for development of Taman Teknologi Ladang Air Manis, Kulai, Johor)	1	3.5	+2.5
Sentuhan Budiman Sdn Bhd (funding for MKD's land purchase and loan disbursement to 1MDB)	0.8	0.8	0
SRC International Sdn Bhd (former 1MDB subsidiary's borrowings from KWAP)	3.9	3.6	-0.300
TRX City Sdn Bhd (formerly 1MDB Real Estate Sdn Bhd) (borrowings from Perkeso for Bandar Malaysia)	0.595	0.485	-0.110
1Malaysia Development Bhd ^^	5	5	0
Government-borne guarantees (Jaminan yang perlu ditanggung) [a]	**113.38**	**137.93**	**+24.55**
Federal Land Development Authority (FELDA)	4.1	4.0	-0.1
Lembaga Pembiayaan Perumahan Sektor Awam (LPPSA)	11.5	17.75	+6.25
Perbadanan Kemajuan Negeri Pahang (PKNP)	0.12	0.12	0
Perbadanan PR1MA Malaysia (PR1MA)	3.72	5.00	+1.28
Perbadanan Tabung Pendidikan Tinggi Nasional (PTPTN)	40.2	37.7	-2.5
Bank Pembangunan Malaysia Bhd	6.4	6.35	-0.05
Small and Medium Enterprise Bank (SME Bank)	2.6	2.6	0
Johor Corporation	2.6	2.6	0
Khazanah Nasional Bhd	17	15	-2
Malaysia Debt Ventures Sdn Bhd (MDV)	0.9	0.93	+0.03
Pelabuhan Tanjung Pelepas Sdn Bhd (PTP)	1.84	2.00	+0.155
Penerbangan Malaysia Bhd (PMB)	0.53	0.469	-0.061
Pengurusan Air SPV Bhd (PAAB)	13.11	13.31	+0.2
Projek Lebuhraya Usahasama Bhd (PLUS)	11.0	11.0	0
Sarawak Hidro Sdn Bhd (SHSB) (Bakun hydro-electric project financing)	1.0	1.0	0
Senai Airport Terminal Services Sdn Bhd	0.33	0.33	0
Syarikat Perumahan Negara Bhd (SPNB)	0	0.53	+0.53
Tenaga Nasional Bhd (power plant rehabilitation)	2.55	2.547	-0.008
Turus Pesawat Sdn Bhd (SPV for MAS plane purchase)	5.31	5.31	0
Malaysian Industrial Development Finance Bhd (MIDF)	0	0	0
Sabah Electricity Sdn Bhd (SESB)	0.0017	0	-0.0017
Guarantees not borne by government (Jaminan tidak perlu ditanggung) [b]	**124.81**	**128.54**	**3.73**
Debt guaranteed by the federal government [a] + [b]	**238.2**	**266.47**	**+28.28**

Note: There is a MYR5.23bn variance between government borne guarantees (MYR137.93bn in yellow) and government guarantees to be serviced (MYR132.7bn) in first figure on page 3. The variance is due to 1MDB Sukuk (MYR5bn) and Khazanah's 50% share of MYR455m guarantee under Asset Global (MYR0.23bn).

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