Why Malaysia's upcoming budget matters

Prime Minister Najib Razak is expected to unveil a populist budget this Friday, but don't expect it to derail the ongoing fiscal consolidation

Source: Shutterstock

Expect the fiscal deficit to remain on track

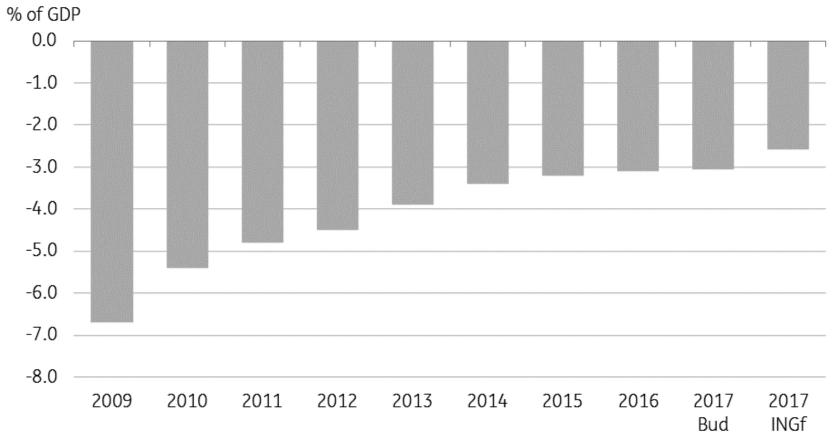
With an eye to holding elections in August 2018, Prime Minister and Finance Minister Najib Razak is expected to unveil a populist Federal Budget for 2018 this Friday.

> *Barring any significant political surprises, we believe the Ringgit will be among the top performing Asian currencies in 2018*

We don't expect election spending to derail the fiscal consolidation underway since 2009, the year the fiscal deficit hit a record high of 6.7% of GDP. Since then, the GDP deficit has come down to 3.1% in 2016 and the government has programmed it to slide further to 3% in 2017, the lowest print since 1998.

Strong GDP growth, higher oil prices, and improved revenues have raised the scope for fiscal outperformance this year. A 2.2% year-to-date increase in central government revenue through to August was a marked improvement over the 5.6% fall in the same period last year, while spending growth slowed to 1.7% from 3.4% over the same period.

Steady fiscal consolidation



Source: ING, Bloomberg

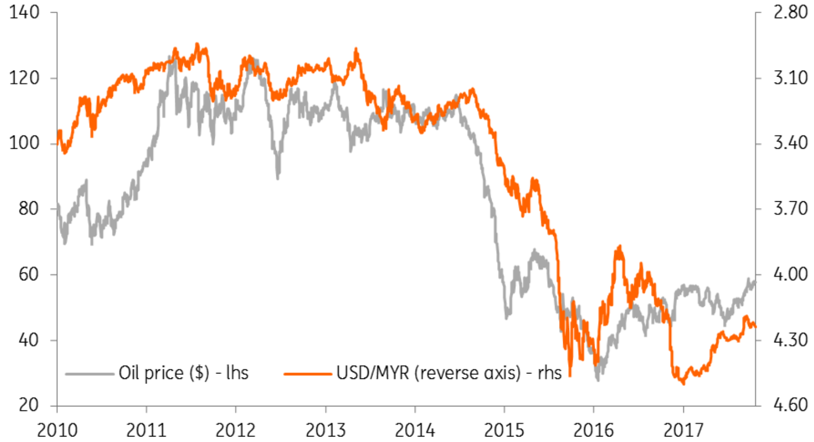
Half percentage point increases in growth and CPI

Based on these trends, the deficit is likely to hit 3% of GDP in 2017. We anticipate the government projecting another year of sub-3% budget deficits in 2018 based on a further improvement in growth and commodity prices. However, the reduced space for further fiscal consolidation will be a risk to the goal of a balanced budget by 2020, in our view. The budget will also include official growth and inflation forecasts for 2018.

We expect half a percentage point increase in the growth forecast to 4.5-5.5% and the same for the CPI forecast to 2.5-3.5%, with actual outcomes likely to be close to the lower ends of these ranges due to the high base year effects. ING forecasts are 4.8% and 2.5%, respectively.

A more likely source of downside risks to these forecasts is accelerated Malaysia Ringgit (MYR) appreciation, which will be associated with slower exports and lower imported inflation.

Oil drives the Malaysian Ringgit



Source: ING, Bloomberg

Bottom line

Fiscal policy and the central bank's monetary policy remains accommodative, at least until the elections.We expect a policy mix that will support prospects of continued strong economic growth. With no significant political surprises; we believe the Malaysian Ringgit (MYR) will be among the top performing Asian currencies in 2018.

Our USD/MYR forecast is 4.19 for end-2017 and 4.00 for end-2018.