

Budget likely to please voters but ignore reforms

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By Siva Sithraputhran & Anuradha Raghu, Reuters

Prime Minister Najib Abdul Razak is expected to unveil a voter-pleasing budget on Friday, placing the priority on winning a tough election above addressing the country's rising debt burden.

Economists say Najib will likely delay much-needed reforms to broaden Malaysia's tax base and reduce its dependence on oil revenues to at least next year, while announcing measures to help poorer families struggling with rising living costs.

Strong revenues in 2012 mean Najib can afford to be generous in the budget for next year without alarming financial markets, but further signs of fiscal slippage would add to investor concerns over a steady deterioration in Malaysia's finances.

The South-East Asian country's public debt as a percentage of GDP is just short of its self-imposed ceiling of 55 percent - up from 43 percent in 2008 - while its budget deficit of 4.7 percent in the first half of 2012 is the third-biggest in Asia after Japan and India.

Fitch Ratings said in August that Malaysia's public finances were weak compared with other countries on equivalent sovereign ratings (A minus) and on a par with heavily indebted countries such as Italy and Israel.

"Very plainly this is going to be an election budget. It's going to be generous," said Irvin Seah, an economist at DBS Bank in Singapore. "At this point, the need for political support will take precedence over some economic considerations."

Najib must call an election by next April and has already announced a series of handouts this year, including RM2.6 billion (US\$847 million) in cash payments to poor families, to shore up support for the long-ruling Barisan Nasional coalition.

Although the coalition is widely expected to win the election, it suffered its worst-ever performance in 2008 polls and faces perhaps the closest-ever election this time as the opposition gains ground.

'People-friendly'

Najib, who is also Malaysia's finance minister, is widely expected to announce further cash payments to poorer citizens, combining them with steps to ease living costs for low-income households and public servants. That could give a further boost to the country's buoyant consumer spending.

The economy grew at a brisk annual pace of 5.4 percent in the second quarter, but many lower-income and middle-class Malaysians complain their salaries have not kept pace with rising living costs and surging house prices.

"The budget will be people-friendly and will ensure the country will achieve its goal to become a high-income nation by 2020," Malaysia's Deputy Finance Minister Donald Lim told reporters yesterday.

Helped by strong economic growth, Malaysia's revenues for 2012 are expected to top RM200 billion, well above the government's RM187 billion target. But public spending is also growing, raising doubts over whether the government can achieve its goal of keeping the fiscal deficit at 4.7 percent of GDP this year.

Several large infrastructure projects, including the RM50 billion Mass Rapid Transit transport project in Kuala Lumpur, are helping insulate Malaysia from slowing activity around the world but also risk increasing its debt burden.

Rating agencies Standard & Poor's and Fitch recently warned of rising fiscal pressures in Malaysia that could lead to a downgrade.

"While we are relatively positive about Malaysia's growth and inflation outlook, we are concerned about its fiscal position," said Credit Suisse analyst Santitarn Sathirathai in a research note.

The ratings agencies want the government to introduce a goods and services tax to widen its revenue base in a country where only about 10 percent of the workforce pays income taxes and to cut fuel subsidies that are among Asia's highest. Malaysian policymakers have signalled they plan to implement those reforms, but not before the upcoming election.

Najib is expected to set the deficit target for 2013 lower than the 4.7 percent goal for this year. In one bow to fiscal discipline, he is unlikely to announce any corporate or individual income tax cuts.

Gundy Cahyadi, an economist at OCBC Bank in Singapore, said the government will be hoping that the heavy spending now will pay off in coming years through higher revenues.

"People forget that it's just like any business decision - you need to invest a lot at the initial stage."