Malaysia Budget 2022

As expected, the Malaysian government announced an expansionary budget for 2022 to boost growth and drive post-pandemic recovery. A myriad of measures supporting the lower-income group and small businesses were rolled out but one of the highlights of the budget was undoubtedly the imposition of a one-off tax known as Cukai Makmur or "Prosperity Tax". In this investment note, we examine the potential investment implications for Malaysian financial markets from the measures proposed in Budget 2022.

Table 1: Malaysia Federal Government's revenue and expenditure

	2020 (RM billion)	2021 estimate (RM billion)	Budget 2022 (RM billion)
Revenue	225.1	221.0	234.0
Total expenditure[1]	314.0	320.6	332.1
Operating expenditure	224.6	219.6	233.5
Gross development expenditure	51.4	62.0	75.6
COVID-19 fund	38.0	39.0	23.0

Note: [1]Total expenditure = Operating expenditure + Gross development expenditure + COVID-19 Fund
Source: Maybank IB Research, 31 October 2021, "Malaysia Budget 2022: Reinforcing the nascent recovery"

Impact on fixed income market

Despite being the nation's largest budget to date, the Malaysian government had steadfastly adhered to a fiscal consolidation path. The government guided for a fiscal deficit of 6.5% of gross domestic product (GDP) in 2021, and targeted a narrower deficit of 6.0% of GDP in 2022. Deficit reduction relies mainly on expected GDP rebound next year. The revenue target looks fairly reasonable this time round given the one-off tax and other tax-enhancing measures. Crude oil price assumption of USD66 per barrel for 2022 is also reasonable relative to oil price outlook at this juncture.

The government has committed to strengthen fiscal management by formulating i) Fiscal Responsibility Act to institutionalize fiscal prudence and governance; and ii) Medium-Term Revenue Strategy to broaden the nation's revenue base.

Malaysia's sovereign rating has been under pressure since the start of the pandemic, with S&P retaining a negative watch on the country's credit rating. Although Budget 2022 did not lay out concrete details on structural fiscal reforms, the government's consistent signalling of intention to do so is likely to stave off rating downgrades for the time being.

Naturally, the nation's need to fund fiscal stimulus packages and Covid-19 measures translates to higher borrowings and thus higher government bond supply. The elevated bond supply scenario, however, has been anticipated by the market for some time and to a large extent, has been factored into current bond yields and pricing.

On the contrary, supply-demand dynamics for Malaysian government bonds actually improved due to higher demand from the largest pension fund in Malaysia - the Employees Provident Fund - as contributor withdrawal schemes reach tail end. Demand for bonds is also supported by the significantly cheaper bond prices after the recent bond selloff.

Having said that, it remains difficult to turn bullish on the local bond market given that the macro backdrop is one of rising rates environment and tapering-induced receding global liquidity. Concerns over cost-push inflationary pressures due to the energy crunch and supply disruptions also lead to higher bond yields. In confluence, these factors tempered our outlook for local bonds despite cheaper valuation and more constructive demand. In the near-term, yield movements are likely to be influenced by regional and global factors, more so than local ones.

Within Malaysia, we expect the economy reopening in 4Q 2021 to raise growth prospects meaningfully and allow Bank Negara Malaysia to keep the Overnight Policy Rate unchanged at 1.75% for the rest of the year. The expected economic improvement should also bode well for the country's credit market in general.

Portfolio impact:
Impact from Budget 2022 to the fixed income market is almost negligible given that there were no major surprises in terms of the country's debt financing requirement and fiscal position. Our Malaysian fixed income strategies maintained a defensive portfolio, with short duration positioning to minimize market risks. We still prefer to invest in short-to-medium term corporate bonds to enhance income return for our strategies.

Impact on equities market & strategies

The main surprise to the equities market in Budget 2022 was the "Prosperity Tax", which is aimed at increasing federal government revenues to shore up the government's fiscal position. Companies with chargeable income up to the first RM100 million will be subjected to the usual 24% corporate tax, while the remaining chargeable income will be subjected to a 33% tax in assessment year 2022.

The income threshold for the higher tax rate means that the "Prosperity Tax" is applicable to many large-to-mid-cap stocks, which led to knee-jerk selling by investors across the board as post-pandemic earnings recovery could be dampened. The FBM KLCI declined 2% on the first working day after Budget 2022 was unveiled.

That said, corporates will require some time to accurately guide on impact of this tax to actual earnings, as taxation depends on various factors, including a) proportion of companies' earnings from overseas operations; and b) whether companies enjoy tax incentives for various reasons such as pioneer status and investment tax allowances.

On broad-based basis, the larger the earnings of a company, the bigger the impact of "Prosperity Tax". As such, blue chip telcos, banks, plantation companies and glovemakers will see more earnings impact, whereas technology companies will see less earnings impact because most are relatively smaller and enjoy tax incentives.

We believe impact to the equity market will be buffered by the fact that the tax is only for assessment year 2022. The government has stressed that it is intended as a one-off tax to help support some of the increased requirements of Covid-19 health crisis.

Apart from "Prosperity Tax", some of the other notable measures announced include:

- **Plantations**: Windfall levy tax threshold value for palm oil increased from RM2,500 to RM3,000 for Peninsular Malaysia and from RM3,000 to RM3,500 for Sabah and Sarawak. Levy rates in Sabah and Sarawak adjusted to 3%, similar to the rates in Peninsular Malaysia.

- **Property**: Removal of real property gains tax from 6th year onwards may improve property transactions in the secondary market.

- **Automotive**: Extension on exemption of sales and service tax expected to stimulate car sales. Electric vehicle (EV) incentives are also positive to boost sales for EVs and kick-start EV adoption in the country.

Aside, it was also announced that for stock trading, the rate of stamp duty on contract notes is increased from 0.1% to 0.15% and the stamp duty limit of RM200 for each related note is abolished. While this will increase cost of trading, we do not believe the impact to trading activities will be significant given the marginal increase.

Overall, Budget 2022 has not changed our investment strategy. We continue to believe that portfolio diversification will be key to navigate the current uncertain market. The main investment themes that we like, such as deglobalisation, digitalisation, clean energy and economic reopening remain intact and will continue to anchor the basis of our stock selection.

On the longer term, we remain positive on the prospects of the market driven by anticipation of earnings recovery from the Covid pandemic and reopening of economy. That said, we remain watchful on the impact of China's regulatory reform and the recent power supply constraint. Slowdown in China's growth may have spillover effect on regional growth and performance of Asia equity markets.

Portfolio impact:
Our Malaysia equity strategies are impacted in the short term by virtue of the knee jerk selling across the equity market immediately after the Budget was unveiled. Performance was nonetheless buffered by overweight positions in stocks which benefit from the digitalisation theme, i.e. mostly technology companies which enjoy tax incentives, hence were least impacted by the “Prosperity Tax”.

As our strategies focus on companies with structural earnings growth potential over a longer investment horizon, we are unperturbed by short-term market gyrations and maintain our investment strategy.

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