MEDIA RELEASE

MEDIA STATEMENT
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In conjunction with the release of the National Budget for 2014

Kuala Lumpur, 25 October 2013 – **The 2014 Budget is a right turn at the fiscal cross-roads and reinforces the theme of fiscal responsibility and prudence amid the increased market scrutiny.** The focus on pursuing better targeted, efficient and effective government expenditure, including gradual subsidy rationalization, is clearly a step in the right direction and in line with the Budget theme "Strengthening Economic Resilience, Accelerating Transformation and Fulfilling Promises".

In particular, the introduction of a 6% GST from 1 April 2015 is a very positive development as it exceeded our expectations and will broaden the revenue base and help to narrow the budget deficit going forward. Given that a 4% GST rate would largely be revenue-neutral, the 6% rate bodes well in terms of signalling the government's serious intent to improve its fiscal housekeeping. The exemption of food, piped water supply and transportation from GST is also largely anticipated, while the current sales tax and service tax will be abolished. Coupled with the market-friendly 1% point corporate income tax cut to 24% is the one-off cash assistance of RM300 to BR1M recipient households, as well as an individual income tax cut between 1-3% points to improve their disposable income. These will surely help soothe the GST transition pains.

OCBC Bank's economist, Ms Selena Ling

The 2014 Budget also adhered to an earlier pledge to achieve a 2014 fiscal deficit target of 3.5% of GDP. The fiscal deficit is expected to decline from 4% of GDP this year to 3.5% of GDP in 2014. The lack of a more aggressive fiscal target was attributed to pragmatism in a tougher economic climate. Notably, federal spending is forecast at MYR264.2 billion in 2014, which is 1.1% higher than the MYR261.3 billion estimated for this year, which is in turn 4.6% higher than originally budgeted for. Of this 2014 allocation, RM217.7 billion is for operating expenditure, while RM46.5 billion is for development expenditure. More importantly, the total allocation for subsidy will fall 15.6% to RM39.4 billion or 18.1% of operating expenditure. The key contributor to this will be a lower provision for fuel subsidies (RM22.3 billion) but at 10.3% of operating expenditure will still remain the largest subsidy component.

Federal government revenue is tipped at RM224.1 billion (+RM4 billion yoy) as tax administration and revenue collection improve in line with economic activity. Tax revenue will improve 5.2% yoy to RM172 billion, amid robust corporate earnings and favourable labor market conditions.

We welcome the Budget focus on infrastructure and investments. The launch of the Services Sector Blueprint in 2014 will be interesting to watch as it could invigorate the services engine for the Malaysian economy and provide an additional thruster for growth. In particular, the logistics sector will also see the formulation of a Logistics Sector Master Plan, as well as RM3 billion in soft loans under the Maritime development Fund, while others like aviation and tourism will also see greater policy attention going forward. Schools and the public transport network will also benefit. On balance, this will add to Malaysia's economic competitiveness if executed well.

More macro-prudential measures could help cool sentiments in the housing sector. These included hikes in the Real Property Gains Tax (RPGT), the higher minimum property price threshold for foreigners, the prohibitions for developers from implementing projects that have features of Developer Interest Bearing Scheme (DIBS) to prevent developers from incorporating loan interest rates in house prices during the construction period, and the prohibition for financial institutions from providing final funding for projects involved in the DIBS schemes. These also are in line with regional measures to tackle their respective asset inflation stories.

The economic outlook has stabilised since the first half of 2013. GDP growth clocked in at a decent 4.2% in the first half of this year. Industrial production remains tepid at 2.3% yoy in August, but has improved from the trough in Feb this year (-5.2% yoy). Export and import growth has accelerated, helping to contribute to a MYR7.11 billion trade surplus in August. This contrasted with the year-to-date low of MYR1.04 billion trade surplus seen in April, which should go some way to alleviate market concerns about the narrowing trade surplus. Trade with key trading partners like Singapore, China and Thailand have also picked up. Foreign reserves, which peaked at USD141.4 billion in mid-May this year, also appeared to have stemmed its recent decline. We believe that 4.7% growth is achievable for the full year, albeit this is at the lower end of the official 4.5-5.0% range. Private investment and domestic consumption remain the key growth drivers given the modest global demand conditions.

The growth outlook for 2014 is brighter. The government forecast for 2014 growth is 5-5.5%, up from an estimated 4.5-5% this year. Our 2014 growth forecast is 5.2%, which is inside the official growth forecast range. The premise is an improving outlook for exports which is tipped to expand by 2.5%, while the services and construction sectors are expected to grow by 5.7% and 9.6% respectively. Both private investment and private consumption growth are expected to remain robust and chug along at 12.7% yoy and 6.2% yoy respectively.

For the man on the street, the economic benefits are a low unemployment rate, which is also anticipated to stay low at 3.1% next year (similar to the current August 2013 print of 3.1%) as well as higher per capita income which is forecast to reach RM34,126. The government is also confident of achieving its per capita income target of RM46,500 (or US$15,000) by 2020 or earlier. In addition, the expanded and more generous BR1M program should help soothe the anticipated GST effect during the transition period.

The inflationary outlook also remains fairly benign at this juncture. Even with the upward creep in the headline CPI inflation, BNM has been contented to keep the OPR unchanged at 3% since May 2011. Despite pricing pressure for food, overall CPI inflation clocked in under the 2% handle in August 2013, fighting with Singapore and Thailand for the pole position in ASEAN with the lowest consumer price inflation. The government forecasts 2014 CPI forecast at a low 2-3%, and we concur with this view. Going further out into 2015 however, the implementation of the 6% GST may see inflation temporarily spike, albeit many essential items are exempted.

In summary, the 2014 Budget has exceeded market expectations on the key deliverable of the GST. This should garner positive market reactions and bode well for RM-denominated risk assets in the near-term.

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