## MEDIA STATEMENT
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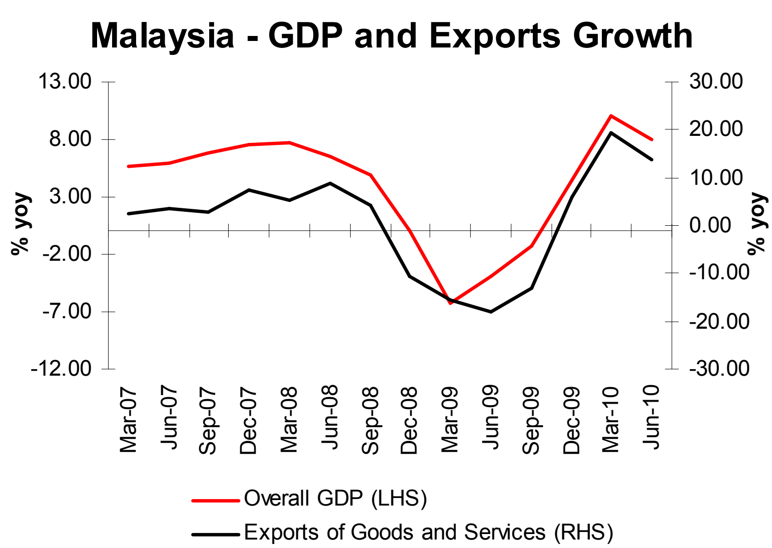
# OCBC: BUDGET ANNOUNCEMENT SET TO BE EXCITING

**Kuala Lumpur, 12 October 2010 – The 2011 budget proposal due to be announced this Friday (October 15) promises to be an exciting one, given that it will be the first budget under the 10th Malaysia Plan** (10MP) and the limelight seems set to fall on how the authorities are going to kick off the New Economic Model (NEM).

The economic recovery seen in 2010 has paved the way for further fiscal consolidation by the government, in line with its target to lower the budget deficit to 2.8% of GDP by 2015. At the same time, the government has earlier indicated that it might start to roll out several of the key projects in the USD 444bn Economic Transformation Programme (ETP). While some doubts on the government's ability to deliver remain, **the first question at this stage is whether or not high government spending is still crucial for Malaysia.**

**The answer to this first question is a resounding "yes".** While it is true that private investment and private consumption has recovered materially in H1 2010, there is little doubt that Malaysia's growth remains mostly driven by export growth. About 80% of Malaysia's industrial production is export-oriented in nature, and export earnings, particularly in the key oil & gas and palm oil sectors, continue to drive business sentiment in the economy.



We expect Malaysia to continue seeing its fiscal expenditure/GDP ratio staying among the highest in the region, at least in the next couple of years, particularly since the government is likely to frontload most of its infrastructure expenditure allocated for the 10th Malaysia Plan. Nonetheless, some sort of fiscal consolidation is likely to be seen, partly as a result of the anticipated increase in oil & gas revenue for the government. After hitting 7% of GDP in 2009, **we expect fiscal deficit to fall to about 5-5.2% of GDP in 2011**, based on our forecast for a 5.4% expansion in headline growth for next year.

| | 2009 | 2010 E | 2011F |
|---|---|---|---|
| **Revenue** | 158.6 | 160.0 | 166.4 |
| **Operational Expenditure** | 157.1 | 152.3 | 156.9 |
| **Net Development Expenditure** | 49.0 | 48.0 | 52.8 |
| **Overall Balance** | -47.4 | -40.3 | -43.3 |
| **% of GDP** | -7.0 | -5.5 | -5.1 |
| **GDP Growth** | -1.7 | 6.7 | 5.4 |

Note: figures in MYR billion and official 2010 deficit estimate is at 5.6% of GDP
Source: CEIC and OCBC estimates

An implementation of the GST system would help to boost the government's revenue base, but given that talks of this have cooled down in recent months, we see only a small chance that the GST will be introduced for 2011, as earlier planned. Recently, Second Finance Minister Datuk Ahmad Husni Hanadziah stated that the government can afford a higher budget allocation in 2011 because of the anticipated increase in revenue due to the implementation of the ETP projects. While the interest & investment returns are among the biggest constituents of the government's revenue, it is unlikely that the ETP projects will be able to bring in significant increase in returns, especially at their initial stage, since the government seems to also want to focus on bigger-scale projects in 2011. **We believe that the increase in revenues would come mainly from higher tax receipts, especially petroleum tax receipts.** Petroleum tax receipts only contributed to about 13% of total tax receipts in H1 2010, well below the 30% average in 2007-2009, and we expect this ratio to converge back up to "normal" in 2011. Additionally, we also expect higher excise tax to be imposed on cigarettes and tobacco products, although the additional revenue from this front is unlikely to be significant.

On the expenditure front, it will be interesting to see which projects are likely to be kicked off in 2011. Going back to the 10MP, we note that there is a total of MYR 230bn allocated for development expenditure, which should come to an average of MYR 46bn over the next 5 years. **Frontloading this allocation to the early half of the 10MP period will be a signal of the government's will to fulfill its Vision 2020 ambition and we expect the authorities to do just that.** Again, on this front, it is important to understand that the government's focus would be on long-term projects including the drive to boost human capital and the building of the Greater KL MRT system. We expect the budget to include special grants and incentives for targeted high-end manufacturing activity (including in green energy sector) and on efforts to boost human capital/technical know-how by way of training or higher education. These would spur on economic activity in the high-end manufacturing sector and other sunrise industries. Meanwhile, **the planned fiscal expenditure on the Greater KL MRT and the high-speed rail system is expected to reach about MYR 50bn over the next 10 years, and we expect the government to start rolling out its dough starting in 2011, although it remains to be seen how much of it will be tabled in the 2010 budget proposal.** Note that there are recent reports that suggest the government might have underestimated the cost of the greater KL system, and thus, some sort of delay in the initial phase of this project might be forthcoming.

Regarding subsidies, **we don't expect the government to expressly announce any significant removal of subsidies in the budget 2011 plan**, especially with lingering doubts about the sustainability of this year's economic recovery. This doesn't mean, however, that the government will not consolidate their subsidies spending next year. While the initial plan was to gradually reduce fuel subsidies by raising fuel price by an average 10 cents/litre every 6 months, a 5 cents/litre revision (similar to the move in July 2010) could still be in the pipeline depending on development in crude oil price next year.

Lastly, one topic that has also been commonly talked about is **the possible implementation of tougher property market restrictions**, especially noting the fact that the authorities have been cautiously watching mortgage loans growth in recent months. One step that may be taken is to lower the loan-to-value ratio for the second (and beyond) property purchase to 70% from 80% previously, similar to what was passed in Singapore recently. This is an important pre-emptive step, especially in light of the announcement of the Greater KL MRT system that is likely to buoy speculation in the KL property market, which has seen bulk of the pressure this year.

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