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Budget 2025: Balancing Act

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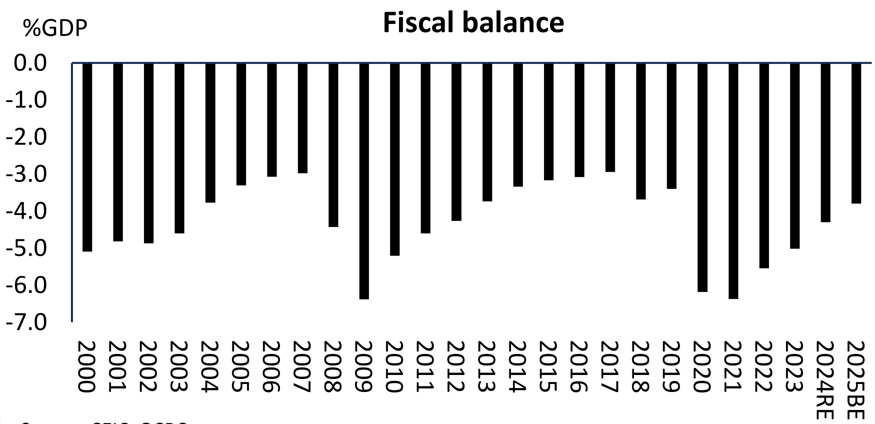
- Budget 2025 is a noble attempt at balancing economic priorities with political realities.
- The government remains committed to fiscal consolidation, targeting a narrower fiscal deficit of 3.8% of GDP from 4.3% of GDP in 2024, broadly in line with our expectations (3.5-3.8% of GDP).
- Our baseline is for Bank Negara Malaysia (BNM) to keep its policy rate unchanged at 3.00% for the rest of 2024 and 2025.

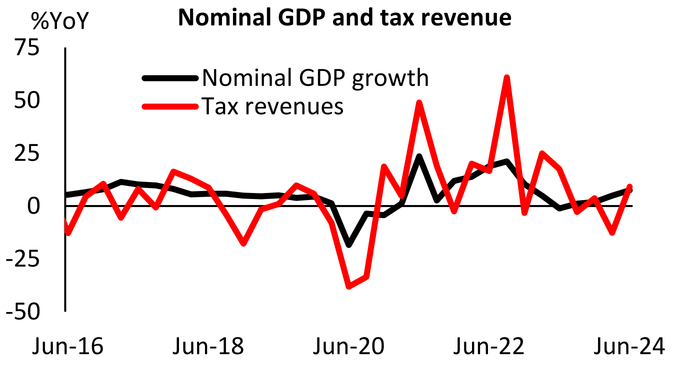
Budget 2025 is a noble attempt at balancing economic priorities with political realities. The government remained committed to fiscal consolidation while boosting economic competitiveness and raising the standard of living; promises that were a part of its pre-budget statement.

The government aims to narrow the fiscal deficit to 3.8% of GDP in 2025 from 4.3% of GDP in 2024 on the assumption that revenues will grow by 5.5% YoY in 2025 (versus 2.3% in the 2024 revised budget estimate) and expenditures will rise by 3.3% YoY after remaining flat in 2024.

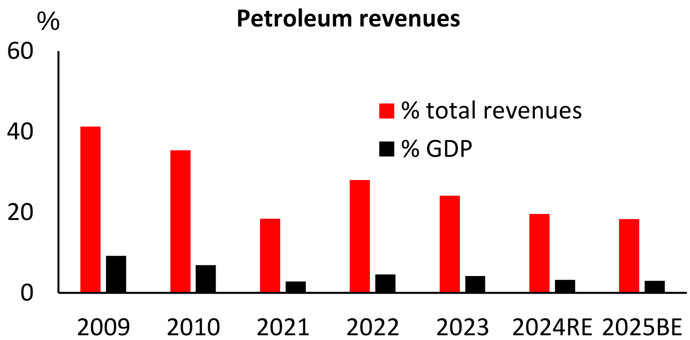


Source: CEIC, OCBC.

Specifically for tax revenues, the government expects direct taxes to rise by 6.6% YoY in 2025 (3.3% in 2024 RE) supported by the phased implementation of e-invoicing[1], higher personal income tax on higher income growth and more civil servants coming into the taxable bracket, following salary increases in December 2024. The government will also impose a 2% tax on dividend income in the assessment year (AY) 2025 for dividend income exceeding MYR100,000. Indirect taxes are projected to rise by 9.8% YoY supported by a broadened scope for sales (extended to non-essential items) and services (extended to commercial services) taxes. More fundamentally, this assumption is consistent with real GDP growth of 4.5-5.5% and headline inflation within the range of 2-3.5% in 2025, as assumed in Budget 2025.



Source: CEIC, OCBC.



Source: Malaysia Ministry of Finance; OCBC

Non-tax revenues are projected to drop by 0.4% YoY even as the dividends from PETRONAS in 2025 are expected to remain unchanged at MYR32bn relative to 2024. Encouragingly, petroleum revenues continue to decline as a share of total revenue and % of GDP – a testament to the broadening of the tax base in recent years.

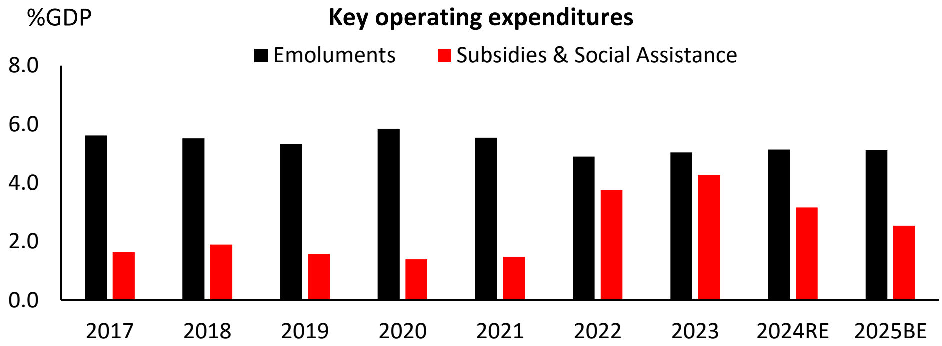
As such, the initiatives to broaden the scope of sales and services tax (effective 1 May 2025), introduce a dividend tax (AY2025), raise excise duties for sugary drinks (1 January 2025) and introduce a carbon tax in certain sectors (iron & steel) in 2026 are steps in the right direction and will help generate incremental revenues, admittedly the extent of additional revenues generation is unclear.

However, as we noted in our budget preview, tax revenue growth rate of 5.5-6.5% may not be adequate to ensure that fiscal consolidation is achieved in line with the Medium-Term Fiscal Framework of narrowing the fiscal deficit to an average 3.5% of GDP in 2025-27. For this, we still believe a more broad-based consumption tax, such as the Goods & Services Tax (GST), is required. The fate of GST re-introduction remained absent from Budget 2025.

[1] E-invoicing applies to all taxpayers undertaking commercial activities in Malaysia. In August 2024, it was mandated for taxpayers with an annual turnover/revenue of MYR100mn. In January 2025, it will be to taxpayers with revenues/turnover of above MYR25mn upto MYR100 and by 1 July 2025 to all taxpayers.

Expenditures skewed towards supporting salaries and pensions

On the expenditure front, the skew was tilted towards operational expenditures, which are budgeted to increase by 4.2% YoY in 2025 versus 3.3% in 2024 (RE). Within this, the most substantial increase is for emolument spending reflecting increases in civil servant salaries scheduled for two phases, the first of which is effective 1 December 2024 and the second in January 2026. Similarly, pensions and gratuities are expected to rise in 2025 versus 2024.



Source: MoF; CEIC; OCBC.

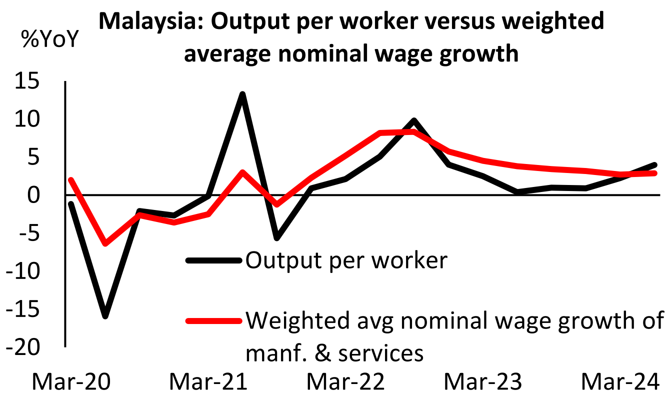
Importantly, subsidies & social assistance spending is projected to drop by 14.4% YoY in 2024. Targeted RON95 rationalisation is expected from mid-2025 onwards, removing assess for the top 15% of earners and foreigners[2]. For the government to achieve its 2025 fiscal deficit target, follow through on RON95 rationalisation is crucial. More importantly, if targeted RON95 subsidy rationalisation does not yield the anticipated fiscal savings, the door should remain open to eliminating these subsidies altogether. Meanwhile, gross development expenditures are expected to remain unchanged at MYR86bn in 2025 versus 2024.

Fundamental commitments remain intact

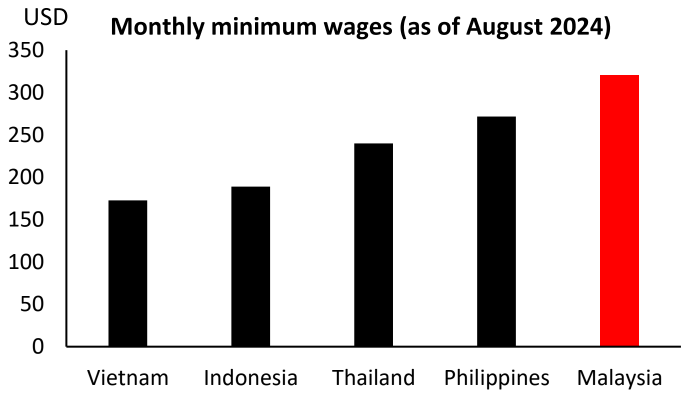
This did not detract from the government's infrastructure spending commitments. For 2025, public investment spending for development is estimated at MYR120bn including MR9bn for projects under the public-private joint venture and MYR25bn for domestic direct investments by GLIC and through GEAR-Up efforts. The infrastructure projects identified by the government focus are regional and aimed at supporting development according to state priorities.

[2] This segment accounts for 40%, or MYR8bn (0.4% of GDP), of the petrol subsidies given out, according to PM Anwar.

The other priority promulgated by Budget 2025 is bolstering wage growth. Minimum wages will be increased to MYR1,700 from MYR1,500 effective 1 February 2025[3]. The Ministry of Human Resources will also issue clearer guidelines for starting salaries for all jobs. This underscores an all-of-government effort to raise the standard of living and keep wage growth competitive. The crucial factor, however, is that wage increases are commensurate with labour productivity. If not, there is a risk that Malaysia could lose some of its competitive edge considering minimum wages are already amongst the highest in the region.



Source: CEIC; OCBC



Source: CEIC; OCBC.

Commitments to supporting the Johor-Singapore SEZ by introducing special incentives towards the end of this year, leading ASEAN -Malaysia 2025 leadership to support hospitality, tourism and businesses, and following through on energy transition priorities were well noted in Budget 2025. The follow through on these initiatives in the periods ahead will be important to further strengthen Malaysia's the quality of economic growth in the periods ahead.

Public debt levels to remain manageable

The government's commitment to fiscal consolidation will also help manage public debt levels. The government estimates that federal government debt growth will slow to around 6% in 2025 from ~7.5% in 2024 and 8.6% in 2023. The debt-to-GDP ratio is expected to remain around 64% by end 2024 and 2025.

[3] If employers have less than five employees for a period of 6 months, the minimum wage increase is postponed to August 2025.

MYRbn	2023	2024		2025	
	Actual	Budget Estimates	Revised estimates	Budget estimates	%YoY
Central Govt Revenue	**315.0**	**307.6**	**322.1**	**339.7**	**5.5**
Tax Revenues	229.2	243.6	241.0	259.0	7.5
Direct Taxes	171.3	185.0	177.1	188.8	6.6
Indirect Tax	57.8	58.6	64.0	70.2	9.8
Non-Tax Revenues	85.8	64.0	81.0	80.7	-0.4
Central Govt Expenditures	**406.4**	**393.0**	**406.3**	**419.7**	**3.3**
Central Govt Current Expenditure	311.3	303.8	321.5	335.0	4.2
Emoluments	91.9	95.6	99.8	105.9	6.2
Pension and Gratuities	34.1	32.4	34.4	40.6	17.7
Debt Service Charges (DS)	46.3	49.8	50.8	54.7	7.7
Supplies and Services	35.9	38.0	39.2	40.7	3.7
Subsidies & Social Assistance	71.8	52.8	61.4	52.6	-14.4
Asset Acquisition	1.0	1.7	1.7	1.2	-30.6
Net Development Expenditure	**95.1**	**89.2**	**84.8**	**84.7**	**-0.2**
Gross Development Expenditure	96.1	90.0	86.0	86.0	0.0
Loan Recoveries	1.0	0.8	1.2	1.3	14.5
Fiscal balance	-91.4	-85.4	-84.3	-80.0	
% GDP	-5.0	-4.3	-4.3	-3.8	

Monetary policy implications

The fiscal measures announced in Budget 2025 will have consequences for inflation and potentially monetary policy. The wider inflation forecast range of 2.0-3.5% for 2025 suggests inflationary pressures could rise on the back of some of the pipeline fiscal measures. The minimum wage increases announced in Budget 2025 taken together with the previously announced civil servants' salary increases in two phases, the first of which is December 2024 will bolster spending, and to that extent be inflationary. For now, we project headline inflation to average 1.9% YoY in 2024 and 2.1% in 2025.

That said, from a monetary policy perspective, we expect that Bank Negara Malaysia (BNM) will remain watchful of these inflationary pressures. While our baseline is for BNM to keep its policy rate unchanged at 3.00% in 2024 and 2025, we will continue to assess the risks around this baseline based on fiscal outcomes.

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