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BUDGET 2025: NAVIGATING PATH TO FISCAL SUSTAINABILITY

	Budget 2024	Budget 2025	
	2024	2024	2025
Real GDP (% y-o-y)	4.0-5.0	4.8-5.3	4.5-5.5
Fiscal Balance (% of GDP)	-4.3	-4.3	-3.8
Estimated Revenue (RM billion)	307.6	322.1	339.7
Tax Revenue (RM billion)	243.6	241.0	259.0
Indirect Tax Revenue (RM billion)	58.6	64.0	70.2
Non-tax Revenue (RM billion)	64.0	81.0	80.7
Revenue (% of GDP)	15.6	16.5	16.3
Total Expenditure (RM billion)	393.8	407.5	421.0
Operating Expenditure (RM billion)	303.8	321.5	335.0
Development Expenditure (RM billion)	90.0	86.0	86.0
Total Expenditure (% of GDP)	19.9	20.9	20.2
Debt (% of GDP)	64.0	64.0	64.0

Sources: Ministry of Finance (MoF), Bank Islam

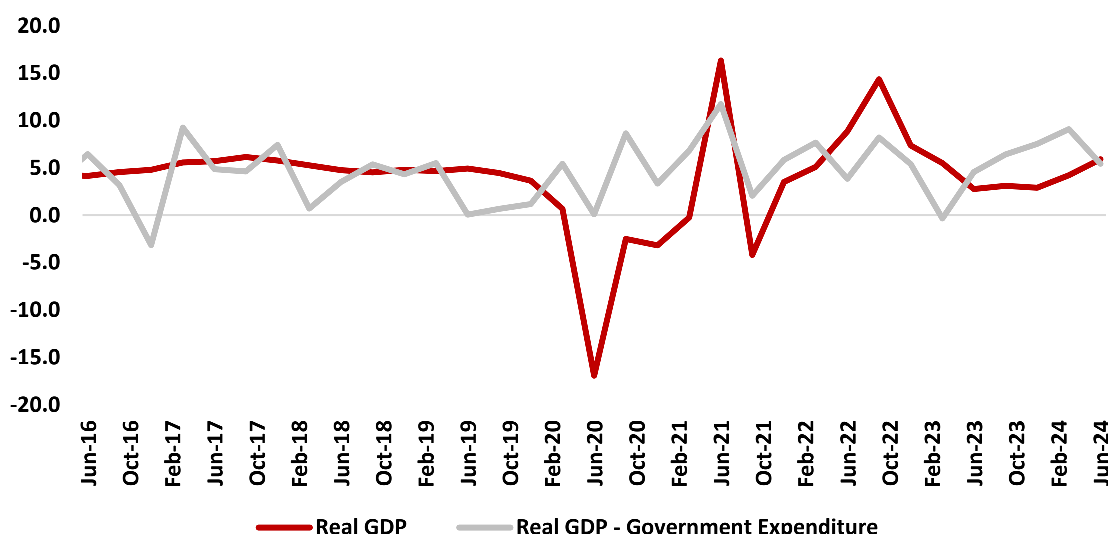
- **The Budget 2025 tabled by Prime Minister and Finance Minister Y.A.B. Datuk Seri Anwar Ibrahim on October 18, 2024, underscores the government's dedication in balancing economic recovery with fiscal responsibility.** The budget was expansionary with total expenditure projected to hit a record high of RM421 billion or 20.2% of GDP. The budget prioritises operating expenditure (OPEX) at RM335 billion, an increase from the previous year. However, as a percentage of GDP, it is expected to decline to 16.1% in 2025, down from 16.5% in 2024. The rise is driven by emoluments exceeding RM100 billion, as civil servants are set to receive a 7%-15% salary hike starting in December 2024, accounting for over one-third of OPEX. However, note that the growth in emolument is milder despite the salary reform (2025: +6.2% yoy) and in our opinion, this is because a portion of the costs are recognised in 2024 and another half likely to be recognised in 2026. Meanwhile, retirement charges are projected to grow by 17.7%, marking an 11-year high, driven by pension adjustments tied to final salary revisions. Debt service charges are continuing to increase, now reaching 16.3% of OPEX, which could mark their highest level in four years.

- **Targeted RON95 petrol subsidies set for mid-2025 rollout.** Subsidies and social assistance, comprising 15.7% of OPEX, are expected to drop by 14.4% to RM52.6 billion in 2025. This reduction is attributed to the rationalisation of electricity subsidies and the introduction of targeted fuel subsidy programs. We opine that the timing is appropriate, considering the decline in global crude oil prices and the strengthening of the ringgit. Rationalising the RON95 subsidy is essential for enhancing Malaysia's fiscal sustainability and resource efficiency, as the government seeks to gradually adjust it to alleviate

budgetary strain and redirect funds to vital services and infrastructure. We expect that that the social assistance allocation will improve with the additional funding for the Sumbangan Tunai Rahmah (STR) and Sumbangan Asas Rahmah (SARA) programs. However, this shift may face resistance, especially from lower-income groups, making targeted financial support vital to cushion the impact. To address this, the government will maintain subsidies for 85% of the population, continuing to shoulder an estimated RM12 billion in subsidies, while the T15 (top 15% earners), described by the PM as the *maha kaya* or super rich, will have to pay more. How exactly the pump prices will be set remains in question. Effective management of this transition will be key to securing public support and ensuring a smooth implementation.

- **Prioritising on local needs over mega projects.** As Malaysia approaches 2025, the final year of the Twelfth Plan, the Development Expenditure (DEPEX) is set to remain unchanged at RM86 billion, emphasising long-term projects in infrastructure, digitalisation, and green energy. We commend the government's initiative to prioritise local needs over mega projects, showcasing a commitment to addressing the specific requirements of communities. By allocating resources to ongoing programs and introducing impactful new initiatives, the government aims to sustain growth and improve the quality of life for the rakyat, delivering immediate benefits while laying the groundwork for long-term sustainable development. Nonetheless, external factors, such as rising oil prices driven by geopolitical tensions, could further strain the budget and add inflationary pressure. The majority of the DEPEX will be directed toward the economic sector (RM40.0bn or 46.5%) with bulk of it budgeted for financing infrastructure projects and social services particularly for essential infrastructure projects. Notable allocations include the construction of additional lanes for the PLUS highway, the Pan Borneo Highway in Sabah, the Sabah-Sarawak Ring Roads, funding for the New Industrial Masterplan 2030, the National Energy Transition Roadmap (NETR), and the Johor-Singapore Special Economic Zone (JS-SEZ) Infrastructure Facilitation Fund.

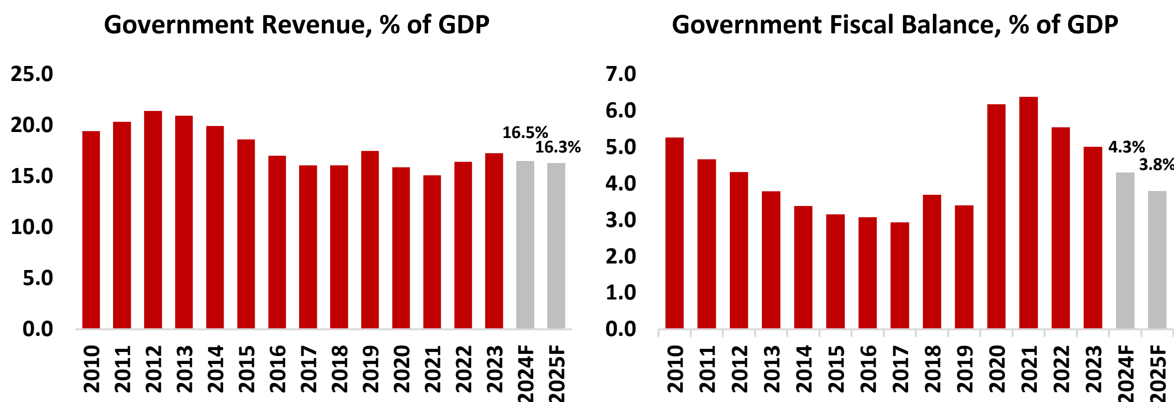
- **A strategic stimulus for sustainable economic recovery.** Budget 2025's stimulus measures emphasise a balanced approach to sustaining economic recovery while fostering long-term resilience. With targeted support for vulnerable groups, including expanded welfare and subsidies, the government addresses immediate living cost concerns. Business support, particularly for SMEs, through grants, loans, and tax incentives, aims to drive innovation and digitalisation. Significant investment in green and digital sectors, along with infrastructure development, aligns with Malaysia's push for sustainable growth. Additionally, increased allocations for education and healthcare further ensure long-term social and economic stability, positioning Malaysia for future challenges. The Ministry of Health (MOH) is allocated RM45.3 billion for next year, up from RM41.2 billion this year, marking the second-highest allocation. This health expenditure is a vital investment to ensure Malaysians remain healthy and can contribute productively to the national economy.



Sources: DoSM, Bank Islam

- **Government revenue is expected to rise by 5.5% to RM339.7 billion in 2025** from the upwardly revised revenue of RM322.1 billion in 2024. Tax revenue – which makes up more than 75.0% of total revenue – is projected to increase by 7.5% to RM259.0 billion (2024: RM241.0 billion). A major contributor is the expansion in the SST, as well as the gradual implementation of the e-Invoice. The increase will offset the marginal contraction of 0.4% by the non-tax revenue (2025: RM80.7 billion vs. 2024: RM81.0 billion), dragged by lower proceeds from investment income despite an unchanged committed dividend payout of RM32.0bn from PETRONAS as well as higher dividends from Bank Negara Malaysia (2025f: RM4.0bn, 2024e: RM2.85bn), Khazanah Nasional (2025f: RM2.0bn, 2024e: RM1.0bn) and KWAP (2025f: RM4.0bn, 2024e: RM3.0bn). Sifting through the breakdown of tax revenues, we note that the increases in both direct and indirect taxes collection are attributable to the revenue enhancing initiatives rolled out in 2024. Thus far, such initiatives had bore fruit, most notably with the indirect tax revenue being revised upwards to RM64.0 billion in 2024 compared to RM58.6 billion estimated in the previous Budget 2024.

- **All in all, the full-year implementation of the said initiatives will further accelerate revenue generation.** Moving into 2025, the government is banking on the full-year implementation of these measures, namely mandatory e-invoicing, capital gains tax as well as the rate increase and scope expansion of the Sales and Service Tax (SST), to draw in higher tax revenue collection. With implementation of e-invoicing initiated in phases since August this year, the companies income tax (CITA) is projected to increase to RM106.5 billion in 2025 (2024: RM98.5 billion). Furthermore, we concur with the view that personal income tax collection (2025: RM44.0 billion vs. 2024: RM40.8 billion) will improve on the back of better labour market conditions as well as the first phase of the civil servant salary hike in December 2024 and minimum wage level increase in February 2025 to RM1,700 from RM1,500 previously. Meanwhile, the petroleum income tax (PITA) is estimated to slow to RM20.7 in 2025 (2024: RM21.8 billion). On the indirect taxes front, the SST is anticipated to generate RM46.7 billion, up from RM40.9 billion in 2024, underpinned by its widened scope and the rate hike from 6% to 8% starting in March 2024.



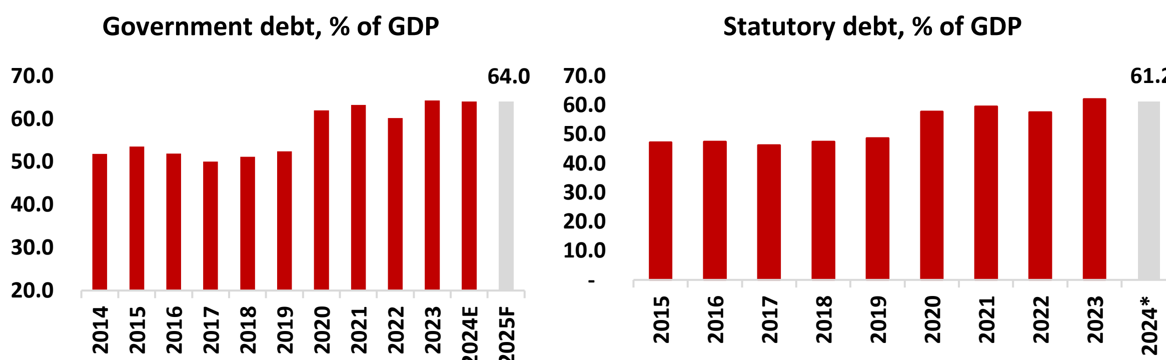
Sources: MoF, Department of Statistics Malaysia (DoSM), Bank Islam

- **Nevertheless, the scales remain uneven.** We would suggest that more revenue enhancing measures could have been implemented, especially taking into account the larger emolument and retirement charges expenditures, which rose above the RM100.0 billion and RM40.0 billion marks respectively. While the government had underlined new proposals of 1) increasing the sales tax rate for non-essential goods such as premium imported goods, 2) expand the services tax scope to include commercial services transactions between businesses (B2B), 3) introduce the dividend tax and 4) implement the global minimum tax starting assessment year 2025, the relative disparity between increases in revenue and expenditure remains wide. This would negate the progress towards the government's target of 3% fiscal deficit in the medium term as underlined in the Public Finance and Fiscal Responsibility Act 2023 (2025: 3.8% vs. 2024: 4.3%). Thus, in staying on track with the goal, the government had embarked on a road to tighten expenditure as well as strengthening public-private partnerships (PPP).

- **Furthermore, we remain concerned on revenue sustainability.** All eyes were trained on the tabling of the Budget, looking out for measures to broaden the tax base but aside from the mentioned, nothing else was unveiled. As it is, the Prime Minister Anwar Ibrahim had signalled that the Goods and Services Tax (GST) will not be reintroduced until the minimum wage hits the range of RM3,000 to RM4,000, which essentially shelves the tax for the immediate term as the minimum wage level is raised only to RM1,700 starting February next year. We also opine that no new consumption taxes will be introduced as the government has set its focus on the RON95 subsidy rationalisation. Thus, this begets the concern of the declining trend of revenue-to-GDP with the assumption of revenue shrinking to 16.3% of GDP in 2025 (2024: 16.5%). The Prime Minister did note that Malaysia stands among the lowest in ASEAN, with tax revenue constituting only 12.6% of GDP in 2023 (Thailand: 16.1% vs. Philippines: 14.1%). While the anticipated strong economic growth and solid labour market conditions could boost our sluggish revenue growth, more concrete measures would be better to ensure stable long-term results and mitigate the drags stemming from possible global economic shocks.

- **On another thread, we laud the government's initiative to reduce petroleum-related revenue.** Of note, the government had outlined its commitment to reduce reliance on petroleum-related revenue in the previous Budget, expecting the share of oil-related revenues to fall to 20.1% of total revenue in 2024 (2023: 24.1%). Recent figures show that the share had eased to less than 20.0% in actuality, clocking in at 19.6% in 2024 before easing further to 18.3% in 2025. The reduced dependence on oil revenue is a focal point of concern due to the heightened geopolitical tensions in the Middle East and

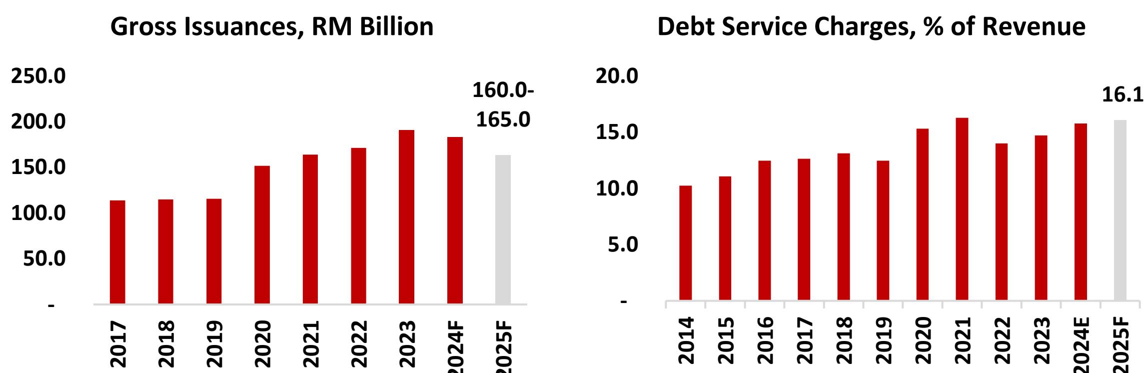
the prolonged Ukraine-Russia conflict. With a large enough exposure to energy exports, a global oil shock will derail Malaysia's crude oil production and revenue outlook. Thus, we commend the government on its attention and actionable strategies in its the revenue diversification efforts.



Sources: MoF, Bank Islam
**as of June 2024*

- **Gradual debt consolidation to achieve medium term target**. As of June 2024, the Federal Government's debt stood at 63.1% of GDP or RM1.2 trillion. While this is still above the medium term 60.0% target set by the Public Finance and Fiscal Responsibility Act 2023 (Act 850), it remains within a manageable range. However, it signals a need for cautious fiscal consolidation in achieving medium term target. In Budget 2025, total federal government debts are expected to stay at around 64.0% of GDP in 2025, the same level as expected in 2024. As at the end of 2023, total federal government debt stood at 64.3% of GDP. The government remains committed to pursue deeper fiscal reforms and further consolidate the fiscal position. Meanwhile, the statutory debt, which comprises Malaysian Government Securities (MGS), Government Investment Issues (GII) and Malaysian Islamic Treasury Bills (MITB), logged 61.2% of GDP as of end-June 2024 (2023: 62.1% of GDP), remained below the statutory limit of 65.0%.

- **Debt and liabilities exposure to trend lower amid the absence of new mega projects.** Debt and liabilities exposures consist of Federal Government debt, committed guarantees and other liabilities, namely financial commitment from PPP and private finance initiatives (PFI) projects. Total debt and liabilities exposures were 82.1% of GDP as of end-June 2024 (2023: 84.1%). Infrastructure projects accounted for the largest share, comprising 58.2% of the total outstanding guarantees issued. This was primarily directed toward public transportation initiatives, including the Mass Rapid Transit (MRT), East Coast Rail Link (ECRL), and Light Rail Transit 3 (LRT3), as well as highway development. Additionally, the Government recently introduced a new policy framework on PPP through the Public-Private Partnership Master Plan 2030 (PIKAS 2030). This plan aims to enhance the management of PPP projects and programs by refining coordination efforts, improving the PPP ecosystem, and introducing new funding mechanisms and structures to alleviate the financial burden on the Government. The policy is comprehensive and robust, designed to effectively address and mitigate risks associated with PPP initiatives.



Sources: MoF, Bank Islam

- **The government remains committed to ensure improvement in fiscal position.** The government's fiscal consolidation continues with a narrower fiscal deficit of 3.8% of 2025 GDP, an improvement against 2024's estimate of 4.3%. While this highlighted the government's ongoing effort to reach its goal of a 3.0% deficit as mandated under the Public Finance & Fiscal Responsibility Act 2023 (Act 850), it seems that the target has been pushed back. Given that there is still a fiscal shortfall of RM80.0bn or 3.8% of GDP next year as compared to the estimated RM84.3bn or 4.3% of GDP in 2024, the government will entirely fund the deficits through borrowings from the domestic market.

- **We foresee government bond issuances in the range of RM160 billion to RM165 billion in 2025.** The figures are based on the upcoming 2025 government bond maturities amounting to RM83.5 billion and the government's projected fiscal deficit of RM80.0 billion in the Budget 2025 tabling. As of the first nine months of 2024, the government has issued Malaysian Government Securities (MGS) and Government Investment Issues (GII) totaled to RM144.5 billion and expects a total MGS and GII issuances of around RM183.0 billion in 2024. Going forward, the emphasis should be on increasing private sector investments, with the goal of enhancing economic capacity and productivity to drive national growth. Simultaneously, the Government's commitment to prioritizing fiscal reforms, including sustainable revenue generation and optimized expenditure, will help achieve the prudent debt levels outlined in Act 850.

- **Debt service charges (DSC) to hover above the 15.0% administrative limit.** The government foresees that the DSC will hover at 16.1% of revenue in 2025 (2024: 15.8%), higher than the administrative limit of 15.0% of revenue amid continuous budget deficit albeit at a declining trend. Though still under control, rising debt service costs could crowd out essential development and welfare spending, limiting the government's capacity to fund long-term projects and social programs.

- **However, foreign exchange risks remained relatively low,** given the small reliance on foreign denominated debt issuances has minimised the government's exposure to foreign exchange risk. The majority of the debt is domestic where foreign currency-denominated debt stood at merely 2.4% of total debt outstanding as of 2Q2024 (2023: 2.5%), which mitigates the risks associated with exchange rate fluctuations. This is a strategic choice to minimize exposure to external shocks and currency depreciation risks. The reliance on domestic markets for financing demonstrates the depth of Malaysia's financial market, providing stability in debt servicing.