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Malaysia's resilient economy

By Ahmad Rafdi Endut

IN eight days, we will witness the dawn of a new year. Word is that next year will be the most challenging year in a long time, at least for Malaysia.

For the past three weeks, business news has been buzzing with reports on the falling price of oil. Economists have frantically begun a guessing game on how the fall will impact the economy.

Will Malaysia's economy be resilient enough to brave the crisis this time around? Some have argued that it is only temporary, while others are quite sure that this will be bigger than the 1997 financial crisis.

The question now is, why is the price of oil falling? Essentially, it is because of a demand-and-supply imbalance.

On the demand side, Europe has experienced its worst economic uncertainty of the past decades, while the world's third largest economy, Japan, officially went into technical recession last month. China has also been slowing down its demand because of the fear of an overheating economy.

On the supply side, the Organisation of Petroleum Exporting Countries decided last month that crude oil output by the cartel would be maintained.

With the United States declaring itself oil independent — thanks to four million barrels per day (BPD) of shale oil produced and another one million BPD expected to be added next year — the supply of crude oil will not see further reduction.

Many are worried that the falling price of oil will, in fact, spell doom for the fiscal policy of the government.

One report has even suggested that the government budget deficit would be hitting -4 per cent of the gross domestic product, instead of the -3 per cent target as announced by the prime minister.

The concern is understandable, since 30 per cent of government revenues are from oil-related products. However, the structure of the oil and gas revenue is much more complex than merely oil prices.

Implicitly, the oil and gas revenue comes from petroleum income tax, production tax and export duties. All of these are based on upstream production and sales.

The downstream (such as liquefied natural gas, or LNG, and motor oil) revenue, on the other hand, comes from corporate taxation and does not fall under the Petroleum Income Tax Act.

What makes this important? Currently, we are a net exporter of crude oil, but we are losing the status as we speak and may become a net importer sooner rather than later.

However, although we are about to become a net importer of crude oil, we are still a net exporter of oil and gas products. Most of the trade surplus in oil-related goods comes from LNG.

LNG prices vary with oil, but not completely, as the long-term contract will set up floor and ceiling prices to protect buyers and suppliers from price volatility.

The prices of other oil products, on the other hand, are probably less volatile to changes in oil prices, and cheaper input cost (such as the price of crude oil) suggests more income to industries. More income to industries means more income to the government in the form of taxes.

I am not too concerned about whether the government can achieve a -3 per cent budget deficit due to the arguments above, but I am worried about how the government will react to such a fall in the price of oil.

There have been suggestions that the government should cut spending on the development budget, such as building new mass rapid transit lines or the Pan Borneo Highway. I question the reasoning behind such suggestions.

As all the revenue comes from the operating budget, I believe that if the government needs to carry out a budget cut, it should involve the operating expenditure first, not the development expenditure.

In theory, the fall in the price of oil will have a direct negative impact on the economy. If we look at current developments, the ringgit falls in tandem with the fall in the price of oil.

Given the circumstances, this will give Malaysia a competitive advantage in terms of other exports, especially in the manufacturing sector.

The decline in the ringgit has buffered a third of the oil and gas revenue, and revenue may not be declining as fast as many analysts would forecast. The trade-off that presents may help plug some holes in government coffers.

As mentioned earlier, the government budget is not just simple revenue minus expenditure. There are dynamics in the system that require more than simple speculation.

Entering the new year, I believe that the fall in the price of oil will not have much negative impact, at least in the short term. In this window, the government still has room to manoeuvre and decide on what to do next. As such, the Malaysian economy will be as resilient as ever in facing the global challenge.

Merry Christmas and a Happy New Year.

A section of the BP Eastern Trough Area Project oil platform in the North Sea, 160km east of Aberdeen, Scotland. Many are worried that the falling price of oil will spell doom for the government's fiscal policy, but it is unlikely that there will be much negative impact, at least in the short term. Reuters pic

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